TAX POLICY CENTER
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STATE AND LOCAL GOVERNMENT REVENUES AND RACIAL DISPARITIES

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The COVID-19 pandemic and the ensuing recession, as well as racial injustices and protest responses throughout 2020, have highlighted that public policies can have very different impacts on populations by race or ethnicity. Tax policies, in particular, are commonly perceived as "race neutral," often because information on race or ethnicity is not solicited in tax collections or explicitly referenced in those policies. But that does not mean tax systems affect people of different races and ethnicities in the same way. We know that Black, Latinx, and Native American households have already been bearing the brunt of COVID-19 cases, deaths, and the economic downturn. Fiscal actions taken by state and local governments going forward can mitigate or amplify these racial inequities, and some places are making targeted efforts to tackle them.

Racism has historically affected government policies and administration and continues to do so today.[1] In a pandemic and recession, these disparities are exposed further. Everything a government does in response, such as decreasing taxes, fees, and charges to alleviate shocks to household incomes, or increasing them to protect the provision of essential public services, can have different effects by race or ethnicity.

However, because the Internal Revenue Service and state and local revenue departments do not ask filers to identify their race or ethnicity when they file their taxes, understanding how racial disparities intersect with taxes can be challenging (Bearer-Friend 2018). Moreover, cost and distributional estimates of "tax expenditures," which include special provisions of the tax code such as preferential exclusions, deductions, deferrals, credits, and tax rates that benefit specific activities or groups of taxpayers, do not typically study their impacts by race or ethnicity.[2]

[1] Kilolo Kijajazi, Jonathan Schwabish, and Margaret Simms, "Racial Inequities Will Grow Unless We Consciously Work to Eliminate Them," *Urban Wire*, July 1, 2020,

[2] Urban-Brookings Tax Policy Center, "What are Tax Expenditures and How are They Structured?," Tax Policy Center Briefing Book, May 2020,

But greater attention is now being paid to analyzing how specific fiscal policies, even those that do not explicitly reference race or ethnicity, affect different racial and ethnic groups. These include a range of federal tax policies, such as the earned income tax credit, the deduction for mortgage interest on homes, and tax credits for student loans.[3]

In our research here, we extend that analysis to state and local government revenues and racial disparities. In particular, we look at how geography intersects with race and the levels and composition of revenues, why the progressivity and regressivity of state tax systems matter, and the intricacies of tax reforms.

The distribution of who benefits or is harmed by specific state and local fiscal policies is crucial to understanding how they affect racial disparities, but these data are not widely collected or estimated. Our exploration here into state and local revenues and their racial implications is therefore foundational, and we hope to build on it going forward by conducting research on the racial equity impacts of specific taxes, such as property taxes and sales taxes.

Researchers are also exploring the social and historical contexts underpinning fiscal policies. Williamson (2020) highlights how during the Jim Crow era, White supremacist ideas helped shape state and local fiscal policies in the constitutions of various Southern state governments. Although some of those policies (such as poll taxes) have been ruled unconstitutional, others (such as limits on property or income taxes and supermajority rules to raise taxes) continue to exist.

The racial inequities these policies yield can have long-term consequences. Avenancio-Leon and Howard (2020) find that Black and Latinx homeowners currently face a 10 to 13 percent higher property tax burden than White homeowners because tax assessments exceed home sales prices in neighborhoods with more residents of color and because of disparities in assessment appeals.[4] Leachman and colleagues (2018) show that states and localities are especially suited to combat racial inequities because they fund most major public services, but they are held back by regressive revenue sources and state legislatures that often do not represent the diversity of their residents (among other factors).

Earlier this year, the federal government expressed its intent to address racial inequities in policymaking and day-to-day operations. President Biden signed an executive order that seeks to advance "equity for all, including people of color and others who have been historically underserved, marginalized, and adversely affected by persistent poverty and inequality."[5] This order includes a directive for all executive departments and agencies to redress inequities in their policies and programs and creates an interagency working group tasked with improving access to federal data that measures and helps advance racial equity.

By centering racial equity and treating it as integral to the planning and implementation of all current public policies or proposals, we can increase our collective understanding of how pervasive, harmful, and expensive racial inequities can be to our economy overall.[6] The Biden administration's prioritization of these efforts can help provide clarity and resources for not just the federal government but for all state and local governments to focus their efforts on narrowing

[3] Aravind Boddupalli and Kim Rueben, "How Income Taxes Interact With Racial Disparities," *TaxVox*, January 30, 2020.

[4] Property taxes are levied based on the taxing jurisdiction's assessments of their value, and the methods local governments use to calculate the real property tax base can vary. For example, some base value on the last sale price or acquisition, while others consider the income that a property could generate based on its use, design, or location. Many state and local governments also use limits, exemptions, and credits to lower tax liability for certain residents. See Urban-Brookings Tax Policy Center, "How Do State and Local Property Taxes Work?," Tax Policy Center *Briefing Book*, May 2020.

[5] "Executive Order on Advancing Racial Equity and Support for Underserved Communities through the Federal Government," The White House, January 20, 2021.

[6] Lisa D Cook, "Racism Impoverishes the Whole Economy." *New York Times*, November 18, 2020; Andre M. Perry and Darrick Hamilton, "Just As We Score Policies' Budget Impact, We Should Score for Racial Equity As Well." Brookings Institution blog, January 25, 2021.

and eliminating racial inequities. This could include making data breakdowns by race or ethnicity more accessible in public datasets or modeling standards or procedures that state and local governments could consider adopting when evaluating public policies or proposals for their racial equity impacts. Indeed, some states and localities, such as California and the District of Columbia, have preceded federal actions with such approaches.[7]

BACKGROUND

Although national fiscal policies also influence racial and ethnic disparities, the varying distribution of population by race or ethnicity is one reason to better understand how state and local policies affect them. Not surprisingly, national averages mask wide variations in populations geographically (figure 1). These variations in composition are caused by a variety of historical demographic and migration patterns, but there are some common trends. Since 2010, the White share of the population has declined in all 50 states, while shares of people of color have grown and are projected to continue rising (Frey 2020).[8]

Differences in racial composition by state also intersect with income. In 2019, median household income by state ranged from $45,792 in Mississippi to $86,738 in Maryland.[9] Louisiana and Mississippi, the two states with the highest shares of Black residents, have some of the lowest median household incomes across the 50 states.[10] More importantly, in both those states, the median income for White households was about twice as high as that for Black households. In fact, in every state and the District of Columbia, the median income for White households was higher than that for Black households, ranging up to three times as high in the District of Columbia. The same is true for the income of Latinx households, which also trailed that of White households in every state except for West Virginia.[11]

At the city level as well, incomes vary dramatically by race or ethnicity: in each of the 100 most populated cities in the country, White people had a disproportionately larger share of personal income than their share of the population. In the five largest cities by population (Chicago, IL; Houston, TX; Los Angeles, CA; New York, NY; and Phoenix, AZ), the share of income aggregated by the White population in those cities was 23 percent more than the White share of the cities' populations.[12]

Differences in the composition of state populations and income by race or ethnicity intersect with the choices state and local policymakers make in how much revenue to raise, what sources of income and spending to tax, and what range of public services to offer.

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[7] Government Alliance on Race & Equity, "California Cabinet Secretaries Pass Racial Equity Resolution." Government Alliance on Race & Equity blog, September 28, 2020; Martin Austermuhle, "All Legislation In D.C. Will Now Be Assessed For Racial Equity." *DCist*, November 12, 2019.

[8] Compared with our data source for race and ethnicity populations, we use the following terms to categorize groups: "Native American" in place of "American Indian or Alaska Native," "Asian" in place of "Asian or Pacific Islander," "Black" in place of "Black or African-American," and "Latinx" in place of "Hispanic or Latino;" "White" remains the same. We acknowledge that not every member of these groups may identify with those terms. We know that language is constantly evolving, and so will we.

[9] "2019 Median Household Income in the United States," United States Census Bureau, September 17, 2020.

[10] Zoe Manzanetti, "State Population by Race, Ethnicity Data," *Governing*, December 25, 2020.

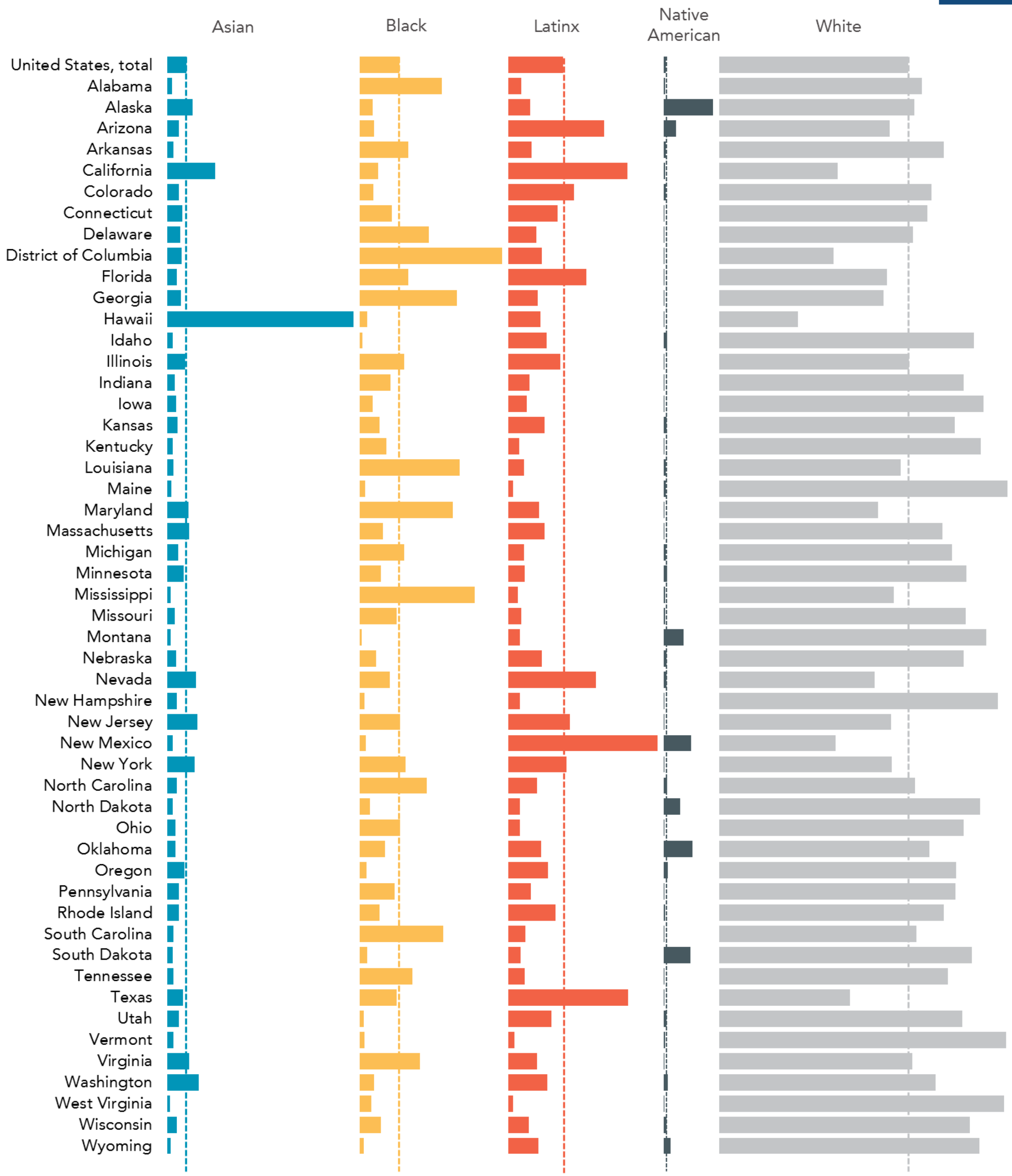
[11] These data are from United States Census Bureau's 2015-2019 5-year American Community Survey estimates accessed by searching "median household income by state" on the United States Census Bureau website. See the "By State," "By State by Race of Householder," and "By State by Hispanic Origin" tables at "Search Results," United States Census Bureau [accessed March 2, 2021], https://www.census.gov/search-results.html?q=median+household+income+by+state&page=1&stateGeo=none&searchtype=web&cssp=SERP.

[12] These data are from United States Census Bureau's 2014-2018 5-year American Community Survey estimates accessed on the Minnesota Population Center website. See Manson, Steve, Jonathan Schroeder, David Van Riper, and Steven Ruggles. IPUMS National Historical Geographic Information System: version 14.0. Minneapolis, MN: IPUMS [accessed December 17, 2020].

FIGURE 1

Composition of State Populations by Race and Ethnicity

All 50 states and the District of Columbia, 2017



Source: US Department of Health and Human Services, Centers for Disease Control and Prevention (CDC), National Center for Health Statistics, Bridged-Race Population Estimates, 1990-2019 (compiled by the CDC via CDC WONDER Online Database; accessed 05-Oct-2020).
Notes: Racial categories are for non-Latinx populations only. The vertical dashed lines represent the composition of the United States overall.

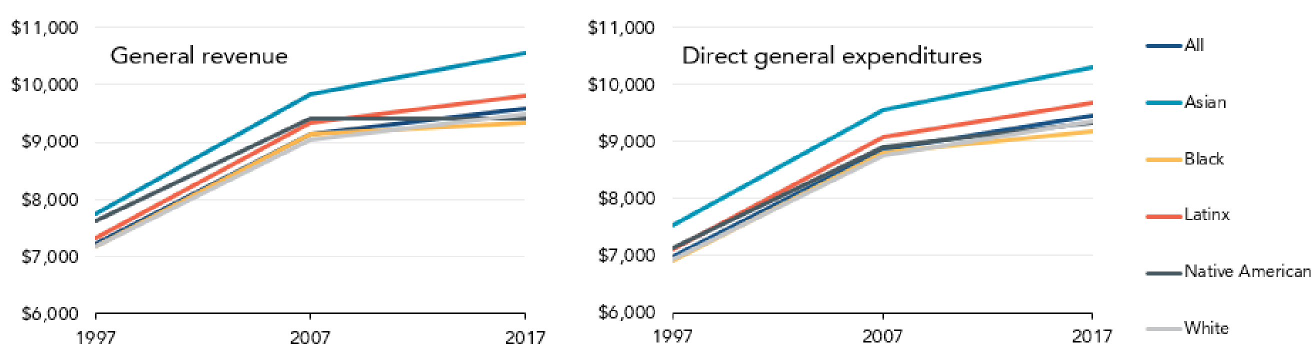
One way of examining how state and local revenue vary by race or ethnicity is to look at how it varies by state based on the composition of their populations. That is, average general revenue per capita across the states weighted by the size of a racial group's population within the state rather than the overall population. This is not the same as estimating the overall tax burden of each racial group, as we do not have information on taxes paid by each individual by race or ethnicity, but it does help highlight how geography influences the level of taxation or provision of public services. Most states are constrained by balanced-budget and antideficit rules, which dictate that their spending must equal revenue over a one- or two-year period, though the stringency of these rules can vary (Randall, Rueben, and Boddupalli 2018). This can complicate our understanding of what higher or lower revenue indicate. For example, a state looking to increase funding for public services needs to raise an equivalent amount by increasing certain tax rates; but the increase in tax rates could disproportionately burden certain taxpayers based on how that tax is structured, and those taxpayers may or may not reap the benefits from what the funds are spent on. Therefore, whether higher state and local revenue is helpful or harmful to residents by race or ethnicity largely depends on the composition and structure of revenues as well as how they are allocated for spending. But we first present information on the weighted averages of state and local revenue per capita cumulatively across the country to see whether these differences are large and whether they have changed significantly over time. This method has been used previously to study racial inequities in education finances and has helped reveal differences in the level of support across school districts that primarily serve low-income students of color versus those that primarily serve low-income White students (Rueben 2019).

General revenue per capita for state and local governments, weighted by total state populations, was about $9,600 in 2017. Since 1997, it increased 33 percent in inflation-adjusted dollars (figure 2). Most of this increase occurred between 1997 and 2007, before the Great Recession, which severely affected state and local governments' financial stability for many years after. By racial and ethnic group, average state and local general revenue across the states cumulatively was highest per Asian resident at $10,600 in 2017. Differences between the other groups were small, ranging from just over $9,300 per Black resident to $9,800 per Latinx resident. Between 1997 and 2017, revenue increased an average of 36 percent per Asian resident compared with 34 percent per Latinx resident, 32 percent per White resident, 30 percent per Black resident, and 24 percent per Native American resident. As we note above, this is not a metric of tax burdens by race or ethnicity; rather, it helps illustrate how levels of revenue intersect with where people live.

FIGURE 2

State and Local Revenue and Spending Averages Per Capita

50 states and the District of Columbia, weighted by race or ethnicity subgroup, 1997-2017



Sources: US Census Bureau, Annual Survey of State and Local Government Finances, 1977-2017 (compiled by the Urban Institute via State and Local Finance Data: Exploring the Census of Governments; accessed 05-Oct-2020); US Department of Health and Human Services, Centers for Disease Control and Prevention (CDC), National Center for Health Statistics, Bridged-Race Population Estimates, 1990-2019 (compiled by the CDC via CDC WONDER Online Database; accessed 05-Oct-2020).
Notes: Amounts in inflation-adjusted 2017 dollars and clipped at Y-axis in the figure. Racial categories are for non-Latinx populations only. General revenue excludes "business-like" government activities such as water and gas utilities or retirement trusts.

In terms of how the revenue raised was spent, direct general expenditures (also weighted by total state populations) increased 35 percent between 1997 and 2017. Similar to general revenue trends, differences between most racial and ethnic groups were relatively small, though increases over time in spending were lowest per Black resident and Native

American resident. Typically, state and local governments that raise more revenue also provide a higher level of public services, though which communities benefit most from those public services can be difficult to conclude because of data limitations. Various researchers have successfully studied the relationship between state and local education finances and population demographics. Over time, school finance equalization efforts have helped narrow funding gaps between school districts within many states, but dramatic cross-state variations persist in education spending per pupil and on a range of fairness metrics (Chingos and Blagg 2017; Baker et al. 2018).

However, patterns across the nation can mask differences across and within regions. Although general revenue per capita is larger overall for Asian and Latinx residents and smaller for Black residents, revenue patterns differ geographically. Table 1 focuses on revenue breakdowns across the four major census regions: Midwest, Northeast, South, and West. Overall, general revenue per capita is much higher in the Northeast and West and lower in the Midwest and South. Property taxes constitute a larger share of general revenue in the Northeast, whereas general sales taxes constitute a larger share in the South. States with large Latinx populations in the South, namely Florida and Texas, do not have an individual income tax, and this is reflected in the significantly smaller share of general revenue from individual income taxes per Latinx resident in the South. California, on the other hand, also has a large Latinx population and drives the higher reliance on individual income taxes per Latinx resident in the West. This is also the case for Black residents in the District of Columbia, Maryland, and Georgia, which are all states that rely more on individual income taxes in the South. Overall, revenue patterns for Black and Latinx residents can reflect clustering in specific metropolitan area cores and states, and some differences are masked when states with disparate revenue makeups are aggregated.

TABLE 1

State and Local Revenue Sources as a Share of General Revenue

50 states and DC categorized by census region, weighted by race or ethnicity subgroup, 2017

Race or ethnicity	Total	Midwest	Northeast	South	West
General revenue per capita ($)					
All	$9,596	$9,128	$12,185	$8,132	$10,473
Black	$9,336	$9,027	$12,663	$8,313	$10,619
Latinx	$9,806	$9,188	$12,870	$7,920	$10,679
White	$9,497	$9,130	$11,884	$8,131	$10,199
Share of general revenue (%)					
Property tax					
All	16.8%	17.0%	21.3%	16.3%	14.0%
Black	16.5%	17.2%	20.9%	15.5%	14.0%
Latinx	17.7%	19.1%	21.9%	19.8%	13.8%
White	16.6%	16.7%	21.2%	15.4%	14.2%
Individual income tax					
All	11.5%	12.4%	16.2%	7.5%	13.6%
Black	11.3%	12.3%	16.8%	9.1%	13.8%
Latinx	10.6%	11.9%	17.0%	3.4%	15.0%
White	11.5%	12.5%	15.8%	8.1%	12.5%
General sales tax					
All	12.9%	12.4%	9.3%	14.6%	13.2%
Black	13.0%	12.4%	9.7%	14.0%	13.7%
Latinx	13.8%	12.4%	9.7%	16.5%	12.9%
White	12.7%	12.5%	9.2%	14.3%	13.4%
Charges, miscellaneous revenue, and federal aid					
All	47.5%	47.2%	41.3%	49.9%	48.6%
Black	47.8%	47.1%	40.9%	50.0%	47.5%
Latinx	46.7%	44.6%	40.1%	48.5%	47.9%
White	47.8%	47.6%	41.7%	50.4%	49.2%

Sources: US Census Bureau, Annual Survey of State and Local Government Finances, 1977-2017 (compiled by the Urban Institute via State and Local Finance Data: Exploring the Census of Governments; accessed 05-Oct-2020); US Department of Health and Human Services, Centers for Disease Control and Prevention (CDC), National Center for Health Statistics, Bridged-Race Population Estimates, 1990-2019 (compiled by the CDC via CDC WONDER Online Database; accessed 05-Oct-2020).

Notes: All state and local revenue sources are not shown. Data for other race or ethnicity subgroups not shown due to smaller population breakdowns by region. Racial categories are for non-Latinx populations only. General revenue excludes "business-like" government activities such as water and gas utilities or retirement trusts.

Within-region differences are driven by the variety of state and local tax systems within that region. For example, the 10 states with the largest shares of Black populations (plus the District of Columbia) are in the South, but the makeup of their revenues vary (table 2). All of them have an individual income tax but most rely more on their respective property taxes. The District of Columbia raises a lot more general revenue per capita and relies less on "general charges" (or nontax revenue sources levied on public services, typically including highway tolls, public hospital payments, sewerage fees, school lunch fees, and state university tuition). Though the District of Columbia's revenue system may not be exactly comparable to those of states, it is rated relatively more equitable overall (Institute on Taxation and Economic Policy 2018). Typically, greater reliance on general sales taxes or general charges can make state and local tax systems more burdensome for low-income residents because those rates are not usually set on a graduated income scale. Alabama and South Carolina derive over a quarter of total general revenue from charges, while Louisiana derives over a fifth of its general revenue from its general sales tax. Alabama and Mississippi, in particular, not only rely more on their general sales tax, they are two of only three states in the country that apply their full sales tax rate on groceries without any tax exemption or offset for low-income families (Figueroa and Legendre 2020). Black residents in the South can therefore face very different state and local tax systems depending on which state they reside in.

TABLE 2

State and Local Revenue Sources as a Share of General Revenue

10 states and DC with the largest shares of Black population, 2017

State	Population	Share of population that is Black (%)	General revenue per capita ($)	Property tax (%)	Individual income tax (%)	General sales tax (%)	General charges (%)	Federal aid (%)
District of Columbia	694,906	47%	$18,720	19%	15%	11%	6%	31%
Mississippi	2,988,510	38%	$8,914	11%	7%	13%	22%	32%
Louisiana	4,670,560	33%	$9,019	10%	7%	21%	15%	31%
Georgia	10,410,330	32%	$6,985	17%	15%	13%	18%	22%
Maryland	6,023,868	31%	$10,484	15%	23%	7%	12%	22%
South Carolina	5,021,268	27%	$8,527	14%	10%	9%	28%	23%
Alabama	4,874,486	27%	$8,206	7%	9%	13%	26%	27%
Delaware	956,823	23%	$10,636	9%	12%	0%	15%	24%
North Carolina	10,268,233	22%	$8,283	12%	14%	12%	22%	24%
Virginia	8,463,587	20%	$8,735	19%	18%	7%	21%	16%

Sources: US Census Bureau, Annual Survey of State and Local Government Finances, 1977-2017 (compiled by the Urban Institute via State and Local Finance Data: Exploring the Census of Governments; accessed 05-Oct-2020); US Department of Health and Human Services, Centers for Disease Control and Prevention (CDC), National Center for Health Statistics, Bridged-Race Population Estimates, 1990-2019 (compiled by the CDC via CDC WONDER Online Database; accessed 05-Oct-2020).

Notes: All state and local revenue sources are not shown. General revenue excludes "business-like" government activities such as water and gas utilities or retirement trusts.

This foundation of information showing differences in state and local revenue by geography and by racial and ethnic groups can help illuminate the diversity of fiscal circumstances in the country. States and localities have some freedom in designing their public finance systems. Factors such as tax rates, the preferential treatment of certain sources of income and spending activities, the menu of various nontax charges and fees will affect disparities by race or ethnicity. Over time, inequitable wages, job markets, homeownership, access to business capital, and criminal justice policies have all played a role in the burgeoning racial income and wealth gaps in the country, and state and local fiscal tools – whether newly enacted or continued by policymakers – have often exacerbated them.

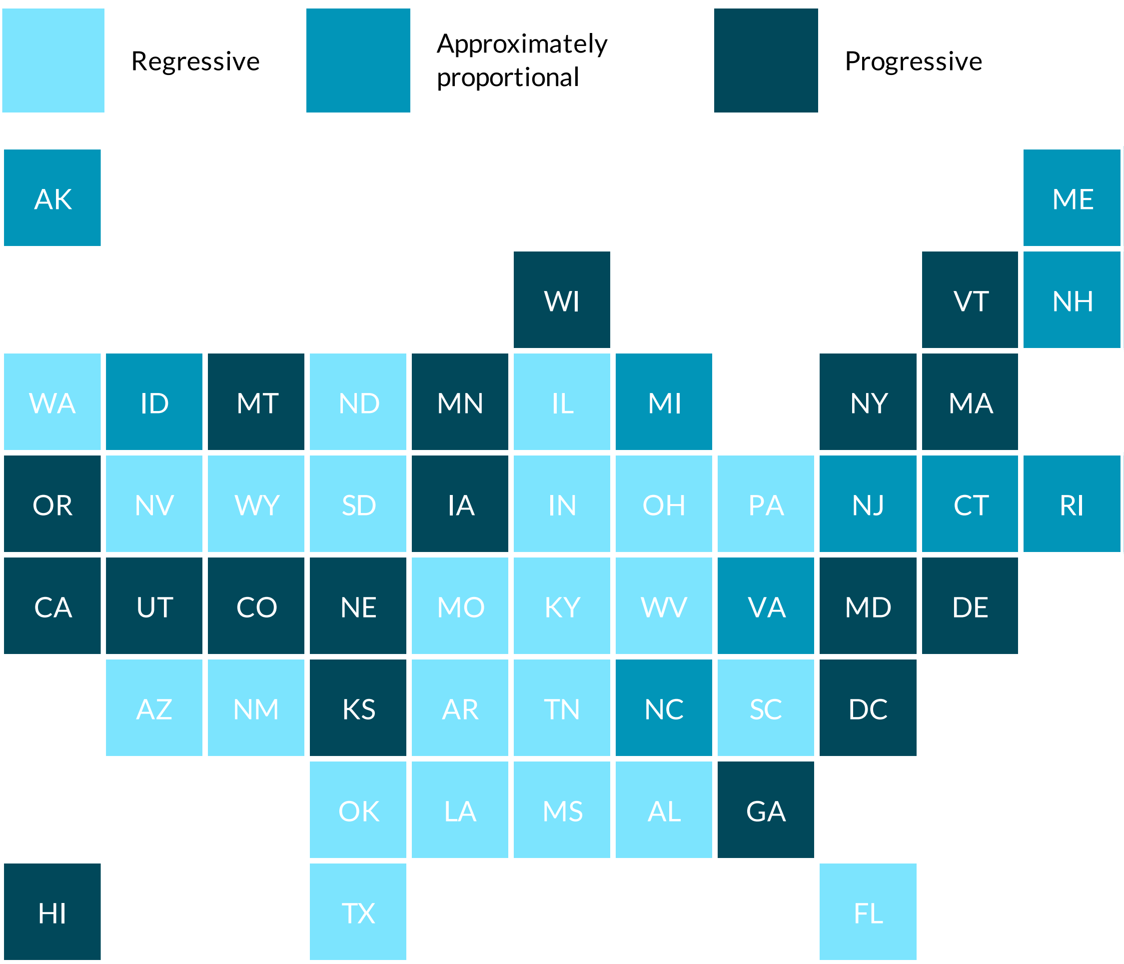
PROGESSIVE AND REGRESSIVE REVENUE SYSTEMS

State governments and local governments collected $1.3 trillion and $1.1 trillion respectively in own-source general revenue (excluding federal aid) in 2017.[13] On a per capita basis among states, this ranged from around $5,200 in Arizona and Tennessee to over $10,000 in Alaska, New York, and Wyoming. But how these funds were raised varied tremendously across the country. For example, the share of state and local own-source general revenue coming from property taxes ranged from 10 percent in Alabama to 49 percent in New Hampshire. Or, for example, severance taxes on the extraction of oil and natural gas, which are a small source of state and local revenue cumulatively across the country, were important for Alaska, North Dakota, and Wyoming. These revenue sources can translate into different burdens based on taxpayers' sources of income and types of spending. Overall, because of differences in household income across racial and ethnic groups, more "regressive" taxes (or those that are levied uniformly and not set on a graduated income scale) can translate into higher tax burdens for people of color.

FIGURE 3

Regressive and Progressive State Tax Systems

Income compression metric for state income, sales, and motor fuels taxes, fiscal year 2011



Source: Cooper, Daniel H., Byron Lutz, and Michael G. Palumbo. 2015. "The Role of Taxes in Mitigating Income Inequality across the U.S. States." *National Tax Journal* 68 (4).

Notes: Based on quantifying the effect of state tax systems (income, sales, and motor fuels taxes) on income inequality by measuring their tendency to compress the income distribution (or the difference between the before and after-tax 90/10 income split). Here, we categorize a state as "regressive" for an income compression metric of under -1.0 percentage points, "approximately proportional" for between -1.0 and 1.0 percentage point, and "progressive" for over 1.0 percentage points.

[13] "State and Local Revenues," Urban Institute, State and Local Finance Initiative backgrounders, accessed March 1, 2021.

Unlike the federal tax system, which is primarily funded by a progressive individual income tax, state and local tax systems are more regressive, meaning low-income households (which include a disproportionately large share of the Black and Latinx population) bear greater tax burdens as a share of their income compared with other households. This reduces the overall progressivity of the combined federal, state, and local tax systems. Cooper, Lutz, and Palumbo (2015) demonstrate that state tax systems in some states, including Louisiana, Mississippi, Tennessee, and West Virginia, effectively undo a significant share of federal tax progressivity (figure 3). Other states, such Minnesota and Oregon, have relatively less regressive tax systems that help further reduce income inequality.

Nearly 60 percent of the country's Native American population are in states with regressive tax systems, compared with 51 percent of the Black population, 50 percent of the White population, 47 percent of the Latinx population, and 28 percent of the Asian population. This is especially noteworthy for Black, Latinx, and Native American residents because they are likely disproportionately burdened by the regressivity of their state tax systems due to their lower average incomes than Asian and White residents. Overall, states with regressive tax systems have a similar distribution of population by race or ethnicity as that of the country overall, whereas states with progressive tax systems have a larger share of Asian residents than that of the country's population.

Policy choices within state and local revenue systems, such as the rates at which taxes are levied, what income or spending is considered exempt, or which activities generate revenue (box 1) can perpetuate inequities. For example, although most states tax income from investments and income from work at the same rate, nine states tax long-term capital gains at lower rates than they tax wages, similar to what the federal government does (McNichol 2018). Because White families hold most financial and nonfinancial assets at significantly higher rates than Black and Latinx families, this means White families are disproportionately likely to benefit from the preferential tax treatment of these assets.[14]

BOX 1

Understanding fines and forfeitures

Revenue systems involve more than just taxes. State and local governments collected $14.9 billion in 2017 from penalties imposed for violations of the law (referred to as fines and forfeitures). Although a small share of total revenue, fines and forfeitures are regressive by design (because they do not vary by income) and are often enforced in a discriminatory way, widening inequities. Interacting with the criminal justice system and being unable to pay fines can have steep costs on the livelihoods of low-income residents.

Overall, fines and forfeitures constitute merely 0.5 percent of general revenue across all state and local governments. But this varies by state, ranging from 0.1 percent in Nebraska to 0.8 percent in Louisiana. One common pattern among states relying most on fines and forfeitures (Alabama, Louisiana, and Texas) is their relatively higher shares of people of color. But state-by-state variations mask local patterns, because cities and townships rely much more on fines and forfeitures.[15]

Five years ago, the United States Department of Justice investigated law enforcement in Ferguson, Missouri.[16] Among the department's findings are that (1) the city's share of revenue coming from fines and forfeitures nearly doubled between fiscal years 2010 and 2015; (2) the police department was responding to pressures from city officials

[14] Aravind Boddupalli and Kim Rueben, "Racial Disparities and the Income Tax System," Urban-Brookings Tax Policy Center, January 30, 2020.

[15] "Fines and Forfeitures," Urban Institute, State and Local Finance Initiative backgrounders, accessed March 1, 2021.

[16] Tracy Gordon and Sarah Gault, "Ferguson City Finances: Not the New Normal," *TaxVox*, April 8, 2015.

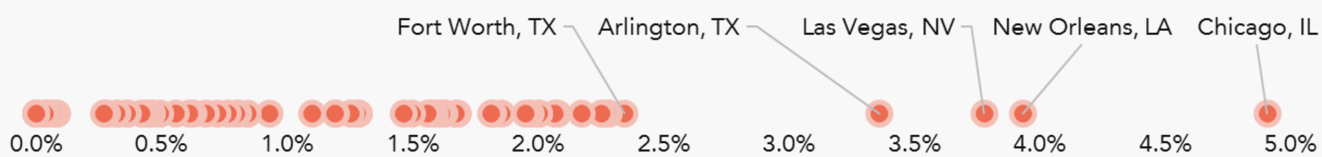
to raise traffic ticket collections to make up for the city's sales tax shortfall; and (3) Ferguson's law enforcement actions imposed a disparate impact on Black residents in violation of federal laws (United States Department of Justice 2015).

This illustrated a perverse relationship, where a city benefited monetarily as more people were punished by the criminal justice system. In Ferguson and beyond, we know that Black and Latinx residents are disproportionately affected by racial profiling in law enforcement.[17] For example, in New Orleans, which is among the cities that rely most on fines and forfeitures (figure 4), Black residents were jailed for failure to pay fines at higher rates than White residents (Laisne, Wool, and Henrichson 2017). Typical fines and fees also do not account for defendants' ability to pay, forcing many into debt and imposing barriers to reentry and rehabilitation (Menendez et al. 2019; Harvard Law School 2016).

FIGURE 4

Fines and Forfeitures Revenues

Cities and townships with population over 300,000, share of own-source general revenue, 2017



Source: US Census Bureau, 2017 Annual Survey of State and Local Government Finances (accessed 05-Oct-2020). .
Notes: Own-source general revenue excludes state and federal government transfers and "business-like" government activities.

When state and local governments rely on very specific charges to keep their general revenue afloat or to prop up certain departments, funding can be more volatile because payment of fines and forfeitures is inefficient and imposes unjust burdens because of inequities in enforcement.[18]

THE RACIAL WEALTH GAP AND TAX EXPENDITURES

The average White family holds about six to seven times more wealth than Black and Latinx families.[19] Major drivers of this racial wealth gap include disparities in homeownership, household income, unemployment, college education, and family inheritances and financial support. Black, Latinx, and Native American households continue to face various aspects of structural racism that impede accumulation of wealth.[20]

Specific parts of the tax system, such as preferential rates, credits, or deductions, have prioritized wealth-creation policies that have disproportionately benefited White households over generations (Strand and Mirkay 2020). The preferential tax treatment of capital gains from financial assets is one such example of tax policies that provide limited tax benefits to low-income households while subsidizing the accrual of wealth for already-wealthy households.[21] This is also the case with retirement assets, because contributions to and earnings from assets in retirement saving plans are generally subject to preferential tax treatment that benefits high-income taxpayers most; whereas employees of color

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[17] Kia Makarechi, "What the Data Really Says About Police and Racial Bias," *Vanity Fair*, November 21, 2019.

[18] Sarah Calame and Aravind Boddupalli, "Fines and Forfeitures and Racial Disparities," *TaxVox*, August 14, 2020.

[19] Aravind Boddupalli, "A New Look at Racial Wealth Inequalities Before the Pandemic," *TaxVox*, December 29, 2020.

[20] "Structural Racism | Urban Institute Next50," Urban Institute, accessed March 1, 2021.

[21] "T20-0152 - Distribution of Long-Term Capital Gains and Qualified Dividends by Expanded Cash Income Percentile, 2019," Urban-Brookings Tax Policy Center, accessed March 1, 2021.

are disproportionately less likely to be in jobs that provide access to employer-sponsored retirement plans.[22] Such public policies have contributed to the widening racial wealth gap over time (Shapiro, Meschede, and Osoro 2013).

Though many of these aforementioned tax policies are primarily at the federal level, states and localities also have tax expenditures and policymakers have some discretion over how to design them to achieve beneficial societal goals. For example, 28 states and the District of Columbia have their own earned income tax credits, and many have expanded their credit amounts and eligibility criteria in recent years to reduce income inequality within their states.[23] Many other state and local tax expenditures, amounting to billions of dollars a year, subsidize economic development projects, homeownership, and employer-provided health care and retirement plans (Boddupalli, Sammartino, and Toder 2020). For example, localities with high levels of income inequality continue to provide tax breaks in the form of large property tax abatements and tax increment financing opportunities to businesses.[24] Though these programs aim to create jobs and foster business-friendly conditions, they can significantly reduce state and local tax revenues and show a poor track record of stimulating economic prosperity for those jurisdictions' residents.[25]

Tax expenditures are a significant form of fiscal intervention, but they are easy overlook because they are administered through the tax system. However, if tax expenditures are ill-considered or poorly designed, they simply provide unwarranted special benefits to certain industries or people. Policymakers looking to restrict ineffective or unwarranted tax expenditures, as with any other public policies, face constraints: most tax expenditures are derived from conformity with the federal tax code, which can be difficult to disentangle from (Boddupalli, Sammartino, and Toder 2020).

When considering state tax expenditure reforms, particularly those that aim to curtail tax benefits to high-income taxpayers and thereby raise their effective tax rates, questions of mobility across state lines are often considered. Previous research has shown that overall, top state marginal tax rates have little effect on the migration patterns of millionaires and billionaires (who are disproportionately likely to be White) and that people tend to remain in places where they gain initial financial success (Young 2017). Those who end up migrating are likelier to move to states with lower or no income taxes.[26] For example, New Jersey's wealthiest resident David Tepper moved from New Jersey to Florida in 2016, reportedly costing New Jersey millions in state tax revenues; sources noted that state taxes were not his primary consideration.[27] In fact, Tepper returned to the state in 2020 for "family reasons," and will now be subject to higher taxes because of New Jersey's "millionaire's tax."[28] The pandemic has raised new questions around the mobility of higher-income households because of the increased prevalence of remote work and the opportunity costs of renting large office spaces for employers. So, while taxes are only one of a myriad of factors that people consider when migrating, the changing nature of work can have important implications for where taxes are collected.[29] In a post-pandemic world, state tax bases and revenue levels might look very different.

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[22] Aravind Boddupalli and Kim Rueben, "Racial Disparities and the Income Tax System," Urban-Brookings Tax Policy Center, January 30, 2020.

[23] "State Earned Income Tax Credits," Urban Institute, State and Local Finance Initiative backgrounders, accessed March 1, 2021.

[24] Mike Maciag, "Big Business Tax Breaks May Worsen Income Inequality," *Governing*, May 2018.

[25] Richard Florida, "How Cities and States Can Stop the Incentive Madness," *Bloomberg CityLab*, November 12, 2019.

[26] Katherine Burton and Hema Parmar, "Hedge Funds Head for Florida With Taxes on Rich Rising Elsewhere," *Bloomberg*, September 23, 2020.

[27] Jon Whiten, "Reality Check: David Tepper's Move Will Hardly 'Destroy' New Jersey's Budget," New Jersey Policy Perspective, April 13, 2016.

[28] Matt Friedman, "'You've got an extra $120 million': David Tepper ditches Florida, moves back to New Jersey," *Politico*, September 24, 2020.

[29] Eric Rosenbaum and Korey Matthews, "How U.S. States Tax Wage Income May be Forever Changed by Remote Work," *CNBC*, November 5, 2020.

TAX REFORM CONSIDERATIONS

Discussions on federal, state, and local tax policy reforms often revolve around whether the increased or decreased tax burden will primarily affect low-, middle-, or high-income households. Common reforms to make tax systems more progressive, such as raising taxes on high-income households and expanding state-level earned income tax credits, are much harder in states that have no individual or corporate income tax. Moreover, these states' reliance on consumption taxes (such as general and selective sales taxes) makes their tax systems more regressive (Institute on Taxation and Economic Policy 2018). How regressive or progressive taxes are also depends on the specific tax structure. For example, general sales taxes that extend the tax base to services but exempt grocery sales are less regressive than sales taxes that are largely levied on all physical goods. However, taxes on services may also be more prone to evasion depending on how the services are paid for. Overall, regressive tax policies can disproportionately impact many people of color because of how race or ethnicity is related with the distribution of income. Therefore, the progressive or regressive nature of tax reforms can impact people disparately by race or ethnicity.

For example, many states and cities are currently exploring how to implement new sales taxes on specific activities (including "sin taxes" on soda, marijuana, or sports gambling), and these are often regressive. Although these can be popular revenue-raising proposals, they can disproportionately burden low-income households.[30] Some of these taxes aim in part to change individual behavior, but they are also more likely to be passed when places need more revenue. If the revenue raised from sin taxes is used to more effectively spend in support of communities that are disproportionately affected by racial inequities (rather than simply to bolster general revenue), their overall effects can be more equitable (Crawford 2021).

Tax reforms initiated by local governments can also face additional hurdles because of "preemption," which refers to the invalidation of local ordinances by state or federal legislators. State governments in the South, in particular, have a long history of wielding preemption laws to prevent localities from implementing more equitable policies regarding stronger labor standards; removing Confederate symbols; and more recently, instituting mask mandates and stay-at-home orders to tackle the COVID-19 pandemic (Blair et al. 2020). This spills over to fiscal policies as well. In 2020, Alabama's state legislature stopped Montgomery's city council from instituting a 1 percent occupational tax (or tax on employees) to raise revenue to fund public services, unless the city first received approval from the state legislature. The dynamics of representation in this conflict are worth keeping in mind: Montgomery is a city with a largely Black population, whereas Alabama's state legislature is largely White (Blair et al. 2020). This can make preemption laws for fiscal policies particularly inequitable, because localities that wish to increase funding for public services or implement other racial equity measures must abide by state legislators that may not have the same priorities. In most states, White people constitute a disproportionately larger share of state legislators than their populations (Leachman et al. 2018).

Reforms undertaken by state and local governments to undo racial disparities will need funding, and it is critical to understand how revenue and spending systems work together. For example, over the past two decades, many state courts and legislatures have mandated education reforms that equalize or change per pupil education spending levels, in order to reduce disparities between school districts that tax and spend at disparate rates. These reforms have helped equalize per pupil spending in some states, especially across school districts that largely serve White students and those that largely serve students of color. Often, this has also shifted the funding responsibility from localities to states; although this can help localities stabilize funding, it can also limit their ability to go above and beyond the state if they wish to enact more equitable measures desired by their residents.

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[30] Urban Institute, "#46 Sin Taxes Are Sweeping the States!," *Critical Value: An Urban Institute Podcast*, February 12, 2020.

Overall, states and localities can benefit from conducting more comprehensive evaluations of how tax reforms directly and indirectly affect their residents by race or ethnicity (Government Alliance on Race and Equity 2016).[31]

CONCLUSIONS AND POLICY IMPLICATIONS

Because state and local revenues do not typically account for race or ethnicity, they appear to be race neutral or "colorblind." However, it is imperative for us to consider how state and local governments can identify and acknowledge racial disparities and then institute solutions to mitigate them. Now, as states contend with how to shore up lower-than-anticipated revenues or how to repair inequities in their economies in the aftermath of the COVID-19 pandemic, is an especially opportune time to consider how revenue reforms can impact people by race or ethnicity. We summarize some of the ways race or ethnicity intersect with state and local revenues, as follows:

- The composition of populations by race or ethnicity varies greatly across states, and this can intersect with the impacts of fiscal choices. For example, an issue or solution of racial equity in one state could look much different from a solution for another state because of their varying demographic makeups.
- Race or ethnicity are not analogous with income or poverty, but they are related because of historical and ongoing discrimination in education, job markets, homeownership, and access to business capital. In most places, White households have disproportionately larger incomes than Black, Latinx, or Native American households, and even larger concentrations of wealth. This means that tax rates that increase with income or wealth (or progressive taxes) can be more effective in closing gaps across not just income levels but also across racial and ethnic groups.
- Differences in state and local general revenue per capita, weighted by the racial composition of those states, are relatively small by race or ethnicity. But over time, adjusted for inflation, the growth in revenue and spending has been smallest per Black and Native American residents cumulatively across the country. Future research should study the impacts of how state and local revenue raised is allocated across neighborhoods within jurisdictions and across spending categories.
- Most state and local tax systems are less progressive than federal taxes, and this can negate the role taxes play overall in reducing income inequality. The lack of individual and corporate income taxes, in particular, can make state and local revenues more regressive and unequally burden low-income residents, who are disproportionately likely to be Black and Latinx.
- The level of taxation and reliance on regressive revenue sources is in part related to geography. Cumulatively, regressive state tax systems have a similar composition by race or ethnicity as that of the country overall, but this can mask certain trends: for example, Southern states are more likely to have lower and flatter taxes. States with larger population shares of Black residents, such as Alabama, Louisiana, and Mississippi, rely more on sales taxes and charges and less on property and income taxes, shifting burdens onto Black residents.
- Tax policies that shift revenue composition away from general taxes onto criminal justice fines and forfeitures can have especially harmful impacts, whether unintentional or explicit, on many people of color. Although fines and forfeitures constitute a small share of state and local revenue overall, certain states and especially cities with larger shares of Black and Latinx populations rely more heavily upon them.
- Some tax expenditures, in the form of preferential rates, credits, or deductions, can provide large tax benefits to already-wealthy households, further widening racial wealth gaps. Most tax expenditures are derived from conformity with the federal tax code, but those at the state and local level can also reduce general revenue available to those jurisdictions, potentially impacting their provision of public services. Despite federal conformity, state and local tax expenditures can be adjusted to ensure that they serve their jurisdictions' priorities.

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[31] Andre M. Perry and Darrick Hamilton, "Just As We Score Policies' Budget Impact, We Should Score for Racial Equity As Well," *The Avenue* (Brookings Institution blog), January 25, 2021.

- States and localities are currently considering a wide number of tax reform options, including instituting sin taxes, expanding earned income tax credits, or adding high-income or high-wealth tax surcharges. In doing so, localities can run into additional hurdles with their fiscal reforms because of preemption.
- Currently, most state and local policymakers do not typically consider the racial equity impacts of programs or proposals, in part because of data limitations. The Biden administration's executive order on racial equity could help increase the extent of data available and the standard procedures undertaken by agencies when considering tax policies. This could provide the impetus for state and local governments to also center racial equity impacts when considering fiscal policies.

Some states have made concerted efforts to narrow rising income inequality in their jurisdictions using all available fiscal tools. Besides increasing top individual income tax rates, expanding earned income tax credits, or instituting sin taxes combined with dedicated spending funds, states and localities are looking at revenue mechanisms explicitly targeted at wealth. Most states already levy real estate transfer taxes, but Connecticut, the District of Columbia, Hawaii, New Jersey, New York, Vermont, and Washington also levy a "mansion tax," or a surcharge on the highest-value homes (Leachman and Waxman 2019). And though many states have repealed their estate and inheritance taxes in the past few decades, recent evidence indicates that fears of inducing mass migration of high-income households might be overblown, and states stand to benefit overall from restoring their estate taxes.[32] Raising revenues from the top of the income and wealth ladder can help narrow inequalities not just by class, but also by race or ethnicity.

States are also considering how to expand certain tax expenditures to boost income security during the pandemic. For example, California and Colorado became the only two states to expand their earned income tax credits to noncitizens in 2020.[33] This was a noteworthy fiscal intervention because even though documented and undocumented immigrants typically pay taxes, they are often considered ineligible or penalized for accessing tax or nontax public benefits. Immigrants (who are disproportionately likely to be Asian or Latinx) contribute hundreds of billions in tax revenue each year, and states and localities stand to fiscally benefit from immigration in the long term.[34] Future research should study the implications of tax reforms for immigrants, because tax systems can be especially complex to navigate for many, and immigration policy changes can make large differences to immigrants' tax burden and access to public benefits.[35]

In recent years, cities are also taking unprecedented fiscal actions, though their policies cannot be considered equivalent to the scale of federal or state actions. Seattle, Washington, recently instituted a 0.7 percent to 2.4 percent additional payroll tax on businesses with over $7 million in annual payroll, specifically for employees earning over $150,000 annually.[36] Effective starting 2021, the city plans on using the funds raised to improve affordable housing, bolster community investment funds, and offer greater small-business assistance during and after the pandemic. Evanston, Illinois, has set up a reparations fund for Black residents and their direct descendants who have experienced racism and discrimination in the city. The reparations fund will include both public housing and education investments as well as direct cash payments, and it will be funded by a dedicated revenue source: the city's sales tax on recreational

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[32] Richard Auxier, "The Death Tax Isn't So Scary for States," *TaxVox*, October 30, 2019.

[33] Michael J. Bologna, Laura Mahoney, and Tripp Baltz. "States Eye Anti-Poverty Tax Credit to Ease Covid Impact," *Bloomberg Tax*, July 29, 2020.

[34] Kim S. Rueben and Sarah Gault, "What Do Immigrants Cost State and Local Governments?" *Urban Wire*, June 5, 2017; Dan Kosten, "Immigrants as Economic Contributors: Immigrant Tax Contributions and Spending Power," National Immigration Forum, September 6, 2018.

[35] Aravind Boddupalli, "Taxpaying Workers Will Be Punished by Trump's New Curbs on Immigrants Receiving Public Benefits," *TaxVox*, August 16, 2019.

[36] Paul Roberts, "Seattle Chamber sues over city's new 'JumpStart' payroll tax on big businesses," *Seattle Times*, December 8, 2020.

marijuana sales.[37] Various other cities, including Asheville, NC; Burlington, VT; Durham, NC; Providence, RI; and St. Paul, MN, are also considering reparations proposals, but some scholars of reparations, such as Dr. William Darity Jr., have raised concerns about some of these proposals not including direct cash payments and conflating relief or economic development with reparations for systematic racial injustices.[38]

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[37] Bookwalter, Genevieve, "Evanston is Using Marijuana Tax Revenues to Fund Reparations. Officials See Home-Buying Help and a New STEM School as Priorities," *Chicago Tribune*, September 1, 2020.

[38] Nick Martin, "Can Cities Do Reparations Alone?" *New Republic*, July 31, 2020.

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