

Choosing an Economic Strategy

Revenue Neutral, Only Sales Tax Reform Creates Jobs

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Taxation > Sales Taxes > 3.0% > 1

Rhode Islanders who follow the news know that Speaker of the House Nicholas Mattiello (D, Cranston) made eliminating the state’s car tax a central promise in his narrow election victory. With the hope of bold thinking about big changes, the RI Center for Freedom & Prosperity wants to encourage Rhode Islanders to think about tax policy in a more-deliberate way with an eye toward its effect.

Having championed *dynamic modeling* of tax policy while proposing the elimination of the state sales tax, the Center wondered how a car-tax elimination plan would stack up against a reduction of the sales tax to 3.0%. We haven’t updated our RI-STAMP modeling tool from the Beacon Hill Institute, so the numbers in the table to the right are as if the policies were enacted in the 2014–2018 timeframe. Also, with no specific plan on the table, we’ve taken the Speaker’s suggestions about using increased revenue from other taxes as the foundation for a revenue-neutral reform.

Because the model doesn’t include a “car tax,” we assumed the economic effects would be the same as if the state were to reduce local residential property taxes by an equal amount. Our sense is that Rhode Islanders think of the “car tax” as a property tax and respond accordingly, and an initial review of national data suggests that consumers don’t tend to react to such taxes as they do to sales taxes, which would be the next-closest analog.¹

Our car tax elimination scenario gradually lowers the amount of the tax over five years (\$40, \$85, \$125, \$170, and \$215 million). In making the policy revenue neutral across the state and municipalities, those amounts are made up 45% with the sales tax and 55% with the income tax, which is the ratio of already-projected increases in those taxes (that is, treating the increase as new taxes).

Because the sales and income taxes have more effect on the economy than local property taxes, we had to chase the rates up to a \$370 million combined tax increase in order to produce the \$215 million in revenue to reimburse municipalities.

The sales tax scenario reduces the rate by one percentage point over the last four years of the five-year window. In this case, we assumed the income tax would be the source for revenue neutrality at the state level. The main dif-

¹ Justin Katz. “Would No Car Tax Increase Car Sales?” January 4, 2017. *Ocean State Current*. oceanstatecurrent.com/analysis/would-no-car-tax-increase-car-sales/

Effects of Revenue Neutral Car Tax Elimination and 3.0% Sales Tax Five Years Out

	Car Tax Elimination	3.0% Sales Tax
Economic effects		
Private employment	-3,065	11,482
Investment	-61.7	288.0
State revenue	16.5	1.8
Sales tax	122.8	-493.0
<i>Policy target</i>	162.9	-585.3
<i>Dynamic difference</i>	-40.1	92.3
Corporate/business tax	-5.3	27.0
Personal income tax	143.8	304.0
<i>Policy target</i>	206.9	94.0
<i>Dynamic difference</i>	-63.1	210.0
Cigarette tax	-5.7	37.0
Other taxes	-3.0	16.0
Other sources	-20.4	106.0
Transfer to munis	-215.0	0.0
Municipal revenue	-22.2	111.6
Sales tax	-0.4	2.0
Residential property tax	-215.0	0.0
Business property tax	-15.8	78.0
Other taxes	-0.7	4.0
Other sources	-5.3	27.0
Transfer from state	215.0	0.0
Total revenue	-5.7	113.4

Notes: Dollar amounts are millions. Rounded numbers may not total as shown.

ference, obviously, is that the lower sales tax generates economic growth, which *reduces* the necessary target for the income tax. A \$94 million income tax increase (about a half percentage point on the rate) would suffice.

Note, as well, that the dynamic effect of a dramatically lower sales tax would also produce revenue at the *local* level. In fact, statewide, the dynamic increase in local revenue alone would be enough to for cities and towns to eliminate half of the car tax on their own.