Taxes increasingly occupy the national mind. Should we raise them, lower them, let them alone, or just talk about them? Certainly we are doing enough of the latter.

The Obama administration seems particularly preoccupied with talking about them, even while wrestling with ballooning national debt, continuing high unemployment, and lethargic economic growth.

But state governments, too, are absorbed with tax questions as they try to balance out-of-balance budgets, operate programs made more expensive by the recession, and grapple with tax systems that produce less and less revenue.

Federal tax questions may be crucial to long-term national prosperity, but a strong argument can be made that state tax problems are the more urgent. Certainly no lasting, national economic recovery can occur while the states remain mired in fiscal turmoil. In fact, the largest lag in job recovery is now coming from the state and local public sector.

State fiscal problems are unique to that level of American government. Unlike the federal government, most states cannot adopt unbalanced budgets. Nor can they borrow over the long term when tax revenues don’t stretch far enough. And those revenues (primarily sales, income, and business taxes) almost never stretch far enough in a recession. Consequently, state revenues go up in good times and down in bad times.

So when recessions strike, state governments generally raise rates or introduce new taxes to balance budgets. For most of the 20th century this pattern of raising taxes was repeated with each new recession. In fact, recessionary tax increases comprised most of the tax increases at the state and local level.

Pennsylvania’s experience is broadly representative. Since the current recession started, Pennsylvania has struggled with soaring deficits, setting off titanic budget battles two years running. Late budgets, threatened state employee layoffs, and program cuts have become so commonplace that they are no longer remarkable. By general consensus, the state faces a $5 billion structural deficit going forward.

But despite the large and growing deficits, there is little likelihood of a tax increase anytime soon. Significantly, neither of Pennsylvania’s gubernatorial candidates has indicated any support for general tax increases. The Republican candidate has taken the no tax hike, not now, not ever pledge, while the Democratic candidate has ambiguously offered no signal that he would support a tax increase.

Thus, Pennsylvania might be in fiscal crisis. But few are talking about a general tax increase to resolve it.

This response differs dramatically from past practice. Throughout most of the 20th century, despite partisan differences, governors and legislatures raised taxes to balance state budgets during recessions. In just the last 25 years, for example, state leaders raised the income tax three times—1983, 1991, and 2003—to meet budget
shortfalls. Indeed, the pattern of raising taxes to combat recessionary deficits was almost Pavlovian in its predictability.

But not this year! Despite perhaps the worst revenue shortfall in Pennsylvania’s history, a tax increase is simply not in the cards.

The obvious question: What is different now?

Surely there are some unusual circumstances that contribute to Pennsylvania’s situation. Since 2005, the Pennsylvania legislature has suffered a series of self-inflicted wounds, including a wildly unpopular pay hike and major scandal involving legislative leaders. The resulting political carnage has driven its approval rating to new lows, severely limiting the capacity of leadership to resolve the state’s fiscal challenges.

Yet these problems have only exacerbated Pennsylvania’s fiscal paralysis; they did not cause it. And they certainly are not the same problems faced by the dozens of other states experiencing fiscal stresses.

Why then are so many states reluctant to do what states have typically done during recessionary times, and simply raise taxes?

This question isn’t likely to have either a simple answer or a single answer. It’s clear, however, that most politicians no longer see raising taxes as a viable option for revenue shortfalls. The political resistance to tax hikes is too intense.

This realpolitik of tax increases is the real dilemma faced today by Pennsylvania and most other states. As we move further into the 21st century, the states confront a radically changed economic world—one in which the economic pie grows slowly and tax increases are a zero-sum game that few taxpayers care to play. In times of prolonged slow economic growth, declining real estate values, disappearing pensions, and high unemployment, there is little appetite for more government spending.

In this changed world, state governments will be challenged to make hard choices as they confront new realities. We are currently testing the limits of government, trying to discover what taxpayers are willing to pay for and ultimately what role the states will play in the American governmental system.

Reducing expenditures, cutting programs, and laying off workers are rarely good politics. But stark choices like these loom in a political universe of dwindling options.

American states now confront one of the most serious challenges they have faced in the past 100 years. How they respond will define federal and state relations in the 21st century and beyond.

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