Triple Whammy: A Regional Sales Tax for Metro, Like Fare Increases and Service Cuts, Would Fall Hardest on Struggling Families

DC Fiscal Policy Institute • Maryland Center on Economic Policy • The Commonwealth Institute

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A strong Metro system is important to all of us in the Washington region. It is fundamental to a healthy economy and our area's good quality of life, by helping workers get to their jobs, supporting our tourism industry, making it easy to get to a restaurant or a ballpark, and reducing traffic congestion. And everyone agrees that the Metro system needs new resources to rebuild its health. But a regional sales tax—a widely discussed option—would be an unfair way to pay for it. A sales tax would ask struggling families in the Washington region to bear the largest responsibility for improving our transportation system, while leaving businesses and high-income households largely off the hook. The sales tax should be rejected as a Metro funding option.

The impact on family income of a 1 percent regional sales tax—a widely discussed Metro funding option—would be five times greater for the lowest-income families in the region, as a share of their income, as it would be for the richest families.

This is because sales taxes always fall more heavily on those living on low incomes. Because families struggling to make ends meet or relying on limited benefits like Social Security must spend every dollar they take in they end up devoting a larger share of their income on purchases subject to sales tax. Put simply, buying things like shampoo, household cleaners, clothes and school supplies takes up a large share of the income for families with limited incomes, while barely registering on the budgets of the well-off or businesses who benefit substantially from a functioning transit system.

IMAGE: CHRIS METCALF/FLICKR

Finding a fairer way to fund Metro is a matter of both economic and racial equity. It does not make sense to add an extra cost to families who already struggle from stagnant wages, rising housing costs, and Metro fare hikes and service cuts. Black and Latino families are more likely to be living on low-incomes than white families, which means that a sales-tax approach would ask communities of color to devote a greater share of their incomes towards fixing Metro.

An equitable approach to funding Metro investments would focus on those who most benefit from a strong regional economy and who have the most ability to pay: larger businesses and higher-income households. A sales tax approach, by contrast, largely lets these groups off the hook.

To avoid falling to the sales tax as the "least common denominator" approach, the best solution to funding Metro is to set targets for each jurisdiction and then allow them to find their own way to meet those targets. Ideally, each jurisdiction will then choose to fund Metro with a set of revenue sources that includes both large businesses and higher-income households.

An equity-focused approach to fixing Metro also means that it should be done with no or minimal cuts to services, no or minimal fare increases, and without sacrificing the wages and benefits of Metro workers.

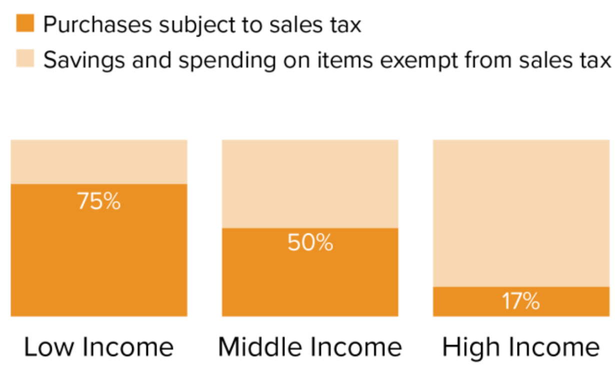
Finally, the proposal by Metro's General Manager to limit operating budget increases to 3 percent a year—as a tradeoff for getting new funds—is a risky approach that is likely to lead Metro to new problems before long. A 3 percent growth rate is unlikely to be sufficient, year in and year out, to support Metro's maintenance needs and basic costs of operations. A 3 percent cap could thus force Metro, in a short amount of time to shortchange maintenance, raise fares or cut services, or look for employee concessions. A 3 percent goal can be established but should include flexibility to go above that should a clear need be demonstrated.

The Sales Tax Is an Unfair Way to Fund Metro

In most states, the sales tax is the least fair tax source. The sales tax falls most heavily on low- and moderate-income residents as a share of income, for two reasons.

First, while the sales tax may seem like a fair tax—everyone pays the same amount for the same purchase—in practice it is not. This is because families with low or moderate income generally have to spend all of their income each month, often on basic goods. By contrast, higher-income persons are able to save a part of their income, and many of their purchases are on services that are not taxed. As a result, households living on low wages or limited Social Security or other public benefits end up paying a larger proportion of their income on taxable items, and thus on sales tax, than do higher-income residents.

Most Spending By Low-Income U.S. Families Is On Items Subject To Sales Tax



Note: Income is defined by U.S. income quntiles. Low income is defined as the bottom quntile (under $21,800), middle income is the middle quintile ($42,000 to $67,800), and high income is the highest quintile (more than $109,900).
Source: Institute on Taxation and Economic Policy estimate based on Consumer Expenditure Survey.

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- For the families with the lowest-income across the U.S., fully 75 percent of their income is spent on purchases subject to the sales tax.[1]
- By contrast, high-income families spend just 17 percent of their income on taxable purchases.

It is not surprising then, that a 1 percent sales tax would fall much harder on low-income families than others.

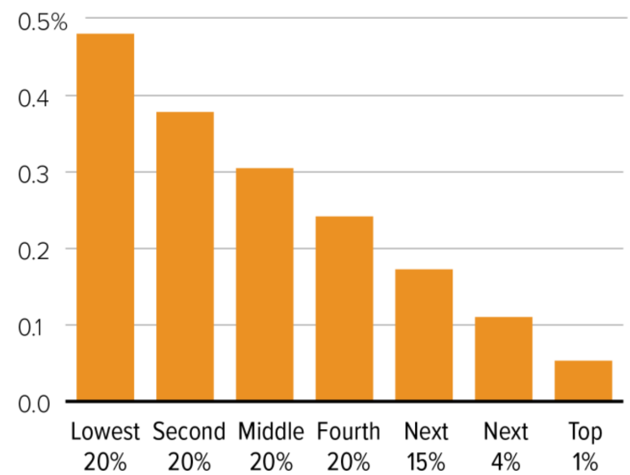
- For the poorest fifth of area families—those with incomes below roughly $25,000—a 1 percent sales tax would consume 0.5 percent of their income, according to analysis conducted by the Institute on Taxation and Economic Policy.[2]
- As income rises, the share of income devoted to a 1 percent sales tax would fall, reaching below 0.1 percent of income for the richest 1 percent of families.

This means that a regional sales tax would fall hardest on families already struggling to cope with DC's high costs of living than on the families, families whose wages are not growing despite the area's strong growth, and disproportionately on families of color.

- Across the region, many families with low incomes face burdensome housing costs. Of renter families in the region with incomes below $35,000, for example, some 68 percent spend more than half of their income on housing, compared with under 1 percent for renter families with incomes above $100,000.[3]
- The benefits of the DC region's growing economy have been very uneven. Wages for the bottom 40 percent of workers have either fallen or been flat since 2007, adjusted for inflation, while wages for the top 30 percent of earners increased more than 10 percent.[4]
- The regional economy has added hundreds of thousands of jobs for workers with a college degree or more advanced education, while it has shed jobs for residents with a high school degree or less. The number of jobs for those with an advanced education was 24 percent higher in 2016 than in 2017, while the number of jobs for residents with a high school diploma is 6 percent lower.[5]

Sales Tax Increase to Fix Metro Requires Region's Poor to Contribute Five Times More Than Top 1%

Cost of a 1 percent sales tax, as a percent of income



Note: Income groupings are statewide but account for the fact that incomes in the DC-adjacent counties are higher than the state averages. Top one percent are those who fall into the top one percent in their respective states, as opposed to the top one percent of the DC region.

Source: Institute on Taxation and Economic Policy Microsimulation Model, 2017.

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Saving Metro through a sales tax also would mean that Black and Latino families in the DC region, who have lower incomes on average than white families, would bear an undue responsibility for fixing Metro's woes. Some 38 percent of Black households have incomes below $50,000, as do 35 percent of Latino families. Only 19 percent of white households have incomes this low.[6]

Given these facts, it is not surprising that polls of area residents find that low-income residents are the most opposed to a sales tax to fund Metro. These families understand the limits of their stretched budgets.

Each Jurisdiction Should Find Its Own Way to Pay

The sales tax has emerged as a preferred funding source for some area leaders, but it is not right to accept a tax that will fall most heavily on families with low incomes, regardless of its other assumed advantages.

It would be better to instead set specific revenue commitments for each jurisdiction, and then let each jurisdiction figure out the best way to fund it. Freeing up each jurisdiction to identify its own funding source would be flexible and allow jurisdictions to find ways that work best for its policymakers and residents. It would enable those jurisdictions that want to develop a more balanced funding solution to do so.

Some argue that this approach does not create the certainty that bond markets will need to back bonds issued for Metro repairs, but that's not the case. If each jurisdiction makes a commitment in a regional compact to a specified funding level, identifies the funding source, and demonstrates that this is sufficient to meet its obligation, then that would appear to be just as secure and as guaranteed as a dedicated sales tax. If needed, each jurisdiction could be expected to reflect its multi-year commitment in legislation.

Those Who Benefit the Most Should Pay the Most, Including Businesses

While the best way to find funding for Metro is to allow each jurisdiction to create its own funding sources and mechanisms, this analysis suggests that the most equitable financing approach would result in costs being borne largely by businesses and higher-income households.

A functioning public transit system is important to everyone, but in the end, a strong Metro is critical to a functioning economy. This suggests that businesses should be expected to shoulder a substantial share of the costs, since their success depends on a strong public transit system. It is no surprise that the Board of Trade, Chamber of Commerce, and Federal City Council all support enhanced funding to strengthen Metro.

All businesses should be expected to contribute, whether they are close to public transit or not, since even businesses not near public transit benefit from the reduced traffic that results from having a strong public transit system. Public transit takes cars off the roads and reduces congestion for those who drive. At the same time, jurisdictions may want to consider revenue increases that fall more heavily on businesses located closest to Metrorail lines, such as an additional commercial property tax for businesses within areas close to Metro stations. While it's likely that these businesses already face higher rents and property taxes because they are in a desirable location, it's also the case that these businesses have the most to benefit from a strong Metro system.

Jurisdictions should also consider ways to make revenue increases on businesses fair, such as by having more modest increases for small businesses, or even an exemption for the smallest businesses. Jurisdictions could, for example, create a "Metro Investment" business fee, with fee amounts that increase with the size of the business.

In addition to business contributions, the remaining costs should be borne largely by higher-income households, both because they can best afford to pay and because they have benefited most from DC's growing economy.

This is an approach suggested by Mayor de Blasio of New York City, who has proposed a "millionaire's tax" to support the subway system.[7] As noted above, the workers with the highest wages and most advanced educations face low unemployment and rising wages, while the large majority of workers without an advanced degree face falling wages, unemployment that has not yet recovered from the Great Recession, and housing costs that squeeze their budgets and leave them financially on the edge.

Metro Should Be Fixed With Minimal Changes to Services, Fares, or Worker Compensation

Fixing Metro in an equitable way also means that it should be done with no or minimal cuts to services, no or minimal fare increases, and without sacrificing the wages and benefits of Metro workers.

- Any reduction in service is likely to fall hardest on lower-income residents and communities of color. These are the residents most likely to be dependent on public transportation. A recent Washington Post analysis shows that DC residents living east of the Anacostia River are the most likely to be low-income, reliant on public transit, and face long public transit commutes.[8]
- Changes in services often mean reducing hours of operation, which fall hard on workers in retail and hospitality who work the earliest and latest shifts.
- Cuts to low-usage bus lines often fall in economically disadvantaged communities where access to employment is hardest.

For similar reasons, fare increases should not be considered or should be kept to a minimum. Like the sales tax, fare hikes would hurt the poorest while leaving businesses and higher-income residents largely unaffected. Families and individuals who must try to make ends meet on low wages or limited public benefits already struggle with the high cost of living in the DC area. Most have no slack in their budget.

Finally, worker compensation is not a major contribution to Metro's financial problems, which suggests that that efforts to find more resources for Metro should not focus on cuts to salaries or benefits for Metro workers. A 2017 report from WSP USA commissioned by the state of Virginia showed that total employee compensation at Metro was actually $2 to $5 less per hour worked than comparable systems across the United States. WSP consultant Roy Kienitz told the Washington Post, "Basically what we're finding is both wages and benefits [at Metro] are average for the transit industry."[9] In 2016, the DC Council reached a similar conclusion. The Council recommended that the contractor that operates the DC Circulator establish wage parity between its bus operators and their counterparts at Metro, acknowledging that Metro worker compensation better reflects the true costs of living and raising a family in the capital region.[10]

Metro will continue to need talented and committed workers. Making it less affordable for them to live and retire in the WMATA service area will only make retention and recruitment more difficult.

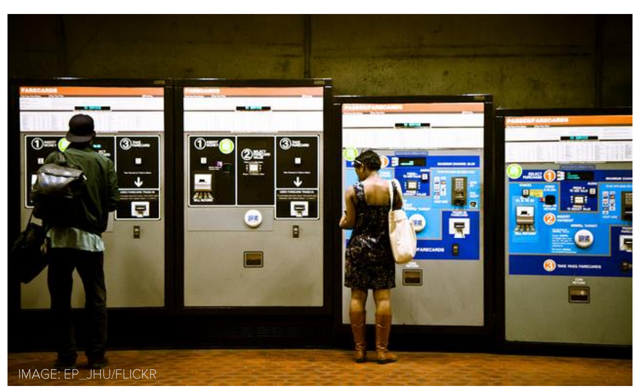
IMAGE: EP_JHU/FLICKR

Artificial Limits on Metro's Budget Is a Recipe for Repeated Crises

The proposal by Metro's General Manager to limit operating budget increases to 3 percent a year—as a tradeoff for getting new funds—is a risky approach that is likely to lead Metro to new problems before long. A 3 percent growth rate is unlikely to be sufficient, year in and year out, to support Metro's maintenance needs and basic costs of operations. A 3 percent cap could thus force Metro, in a short amount of time, to shortchange maintenance, raise fares or cut services, or look for employee concessions—putting the region right back at square one. In other words, a 3 percent cap on Metro's budget could lead to choices that have an inequitable effect on residents with low-incomes and residents of color.

It would be reasonable to set a goal each year of budget growth of 3 percent or less, but this should not be a firm cap. Instead, if after making all budget-saving choices that will not affect services, Metro finds that it needs more than 3 percent, the Metro board should be able to make a request for a larger budget with clear documentation for the higher need. That increase could be subject to enhanced scrutiny by area jurisdictions and of course rejected if area jurisdictions disagree.

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The DC Fiscal Policy Institute promotes opportunity and widespread prosperity for all residents of the District of Columbia through thoughtful policy solutions. DCFPI influences DC budget and policy decisions to reduce poverty and income inequality and to give residents the opportunity for a secure economic future. We accomplish this through research and analysis, direct engagement with policymakers, and strategic partnerships with other organizations and individuals. Essential to accomplishing our mission, DCFPI also furthers ways to make DC public services more effective and to ensure the workings of DC government are open and accountable to the public.

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*DC Fiscal Policy Institute, Maryland Center on Economic Policy, and The Commonwealth Institute are members of the **State Priorities Partnership**. www.statepriorities.org*

[1] Institute on Taxation and Economy Policy estimate based on the Consumer Expenditure Survey.
[2] The Institute on Taxation and Economy Policy analysis was conducted for this report.
[3] American Community Survey, 2010-2014. For DC, MD, and VA portion of metropolitan area.
[4] Economic Policy Institute analysis of Current Population Survey.
[5] Ibid.
[6] American Community Survey, 2010-2014. For DC, MD, and VA portion of metropolitan area.
[7] "Bill de Blasio Will Push for Tax on Wealthy to Fix Subway," The New York Times, August 6, 2017.
[8] "Here's Where D.C. Public Transit Can Take You — And Who Gets Left Behind," The Washington Post, April 17, 2017.
[9] "Despite Criticisms, New Study Finds Metro Workers' Pay and Benefits are Typical for Industry," The Washington Post, July 20, 2017.
[10] Fiscal Year 2017 Budget Report and Recommendations, DC Council Committee on Transportation and the Environment, May 4, 2016.