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• Goal: Explain how states set their tax rates
• Important because state taxes affect revenues, business cycles, and welfare
• Also, for policy analysis – are tax changes exogenous?

• What we do: Focus on 6 tax rates from 1980-2020 (∼80% of tax revenue)
  o Top personal income, top corporate, sales, gasoline, cigarette, and alcohol
• Study long-term trends for signs of competition, Tiebout sorting, polarization
• Quantify to what extent political, institutional, and economic factors can explain the timing and magnitude of tax changes

Finding 1
Little convergence/divergence of tax rates over time
Inconsistent with Tiebout sorting and race-to-the-bottom competition

Finding 2
Increasing polarization of tax levels between Democratic & Republican states since 2000
But no convergence within Dem/Rep states

Finding 3
Timing and magnitude of tax changes hard to predict
Determinants from literature explain <20% of total variation, even when using machine learning
  ➢ Tax policy in neighboring states
  ➢ State recessions
  ➢ Unfunded federal mandates for spending
  ➢ Political cycles & changes
  ➢ Institutional rules (e.g., # of legislators, balanced budget rules)
  ➢ Federal tax policy

• Discussion: Tax setting processes are complicated and are not easily explained by economic, political, or institutional factors
• Politics matter, but provide far from a full explanation
• The models we consider, even combined, do not explain tax policy very well
• Tax policy may be idiosyncratic due to gridlock; or, other factors matter more (e.g., lobbying or political contributions)