A Response to our critics on Philadelphia taxes.

Response to Levy and Camp-Landis

The narrative that Philadelphia is highly taxed is so important to a segment of our political class—mainly the representatives of the business community and the richest Philadelphians—that they rushed to respond to my piece in the Philadelphia Citizen of a few weeks ago. In it, I explained that the data usually trotted out to support the notion that Philadelphia is highly taxed are deeply flawed.

That flawed data compares Philadelphia and other cities that are also counties to cities that are embedded in counties and in which the county governments provide a large share of local services. To fairly compare the tax burden in Philadelphia and cities that are embedded in counties, the share of revenue raised by county governments that provide local services should be included in the revenue totals of those cities. And when you include those county revenues, Philadelphia's tax burden is fairly close to the median burden.

The response to my piece by Paul Levy and Stephen Camp-Landis makes one very good point and then changes the subject, throwing in a lot of misleading and irrelevant statistics for good measure.

Levy and Camp-Landis's initial point is that when we judge whether Philadelphia is highly taxed we should look at the tax rate, that is the share of income taken by taxes, rather than looking at taxes paid person They have a point although I want to note that when Levy and others believed our per capita tax burden was high—as a result of the misleading Pew report I criticized—they had no reluctance to say that tax burden per capita was a useful measure of how high our taxes are.

Levy and Camp-Landis are right, however, that tax rates are more important than tax burden as an indicator of how highly taxed a city is. They rightly point out that the tax rate is a function of both the tax burden and the average income in a city. If the average family or household income of Philadelphians is lower than that of many other cities with a similar tax burden, then the tax rate will be higher.

I have secured comparative data on tax rates from the same source I used in my original piece, the Lincoln Institute of Land Policy. Measured this way, Philadelphia, which has an overall (i.e., average) effective tax rate of 15%, ranks fourth among the largest 30 cities. But this conclusion needs to be seen in light of three factors.

First, the overall tax rate in Philadelphia is far below the highest rate, New York's 20%, and only a few percentage points above the median of 12% for the 30 largest cities. And as we point out in our long paper on the subject, we have no evidence that differences in tax rates of this magnitude have a substantial impact on where people live or where businesses locate. Just as we found with regard to tax burden per capita, Philadelphia's effective overall tax rate is just a little higher than the median. It is certainly not high enough to justify the epithet, "Taxadelphia."

Second, given what tax "reformers" like Paul Levy are concerned about—which is encouraging large businesses and highly paid workers to move to Philadelphia—the overall tax rate is far less important than the tax rate on those highly paid workers. And since taxes in Philadelphia are highly regressive, it is likely that those workers will pay at a lower rate than the average rate paid by everyone else.

We have two sources of evidence about the regressivity of Philadelphia's taxes, which are imperfect because they combine state and local taxes. (My organization is working to develop better evidence on Philadelphia taxes alone.) But each one suggests that the effective tax rate on high income workers is likely to be lower than the overall tax rate.

From work done by the Institute on Tax and Economic Policy (ITEP), we know that Pennsylvania's state and local taxes are among the most regressive in the country. The top 1% of families in Pennsylvania pay only 6% of their income in state and local taxes, while the next 4% pay 7.8%. Our estimate is that the top 20% of families pay 8% of their income in state and local taxes, while the lowest 20% of families pay almost 6 percentage points more at 13.8%. It is likely that the distribution of the tax burden in Philadelphia is similar to that of the state.

The second piece of evidence comes from the annual comparison of state and local tax burdens compiled by Washington, DC. Like the ITEP data it is imperfect for our purposes because it includes both state and local taxes. And, as I'll point out in a moment, this study is flawed when used to compare taxes in Philadelphia to that of other major cities. But it does provide useful information about the distribution of taxes in Philadelphia. Table 1 shows the study's estimate of the state and local tax rate for families at different income levels in Philadelphia, as well as the median rate for the 51 cities studies, which are the largest cities in each of the fifty states plus the District of Columbia.

Table 1

State and Local Tax Burden in Philadelphia Relative to Largest City in Each State					
	Family Income				
	25,000	50,000	75,000	100,000	150,000
Philadelphia rate	18.3%	12.0%	12.0%	11.9%	11.4%
Median rate	11.4%	8.9%	8.9%	9.2%	9.4%
Philadelphia rank	2	7	7	7	14
Source: Government of the District of Columbia, Taxes and Tax Burdens In the District of Columbia–A Nationwide Comparision, April 2020 https://cfo.dc.gov/sites/default/files/dc/sites/ocfo/publication/attachments/2020%20Tax%20Rates%20and%20Tax%20Burdens_Nationwide%20Comparison.pdf					

Table 1 tells us the state and local tax rate in Philadelphia is only 2 to 2.7 points higher than the median for those with relatively high incomes. And its rank among all the cities considered is 14th or the highest income group and 7th for the second-highest income group. (It would likely be lower if Philadelphia were compared to the 30 largest cities not the largest cities in each of the 50 states.) But for the lowest-income Philadelphians, the state and local tax rate is almost *7 percentage points* higher than the median rate, and Philadelphia's rank is second among 50 cities.

While the Washington, DC, compiled data include both state and local taxes, they do estimate the impact of taxes on city residents. The data supports the conclusion suggested by the ITEP data: the state and local taxes paid by Philadelphians are among the most unequal in the entire country. That means, first, that even if there were evidence that high tax rates dissuade people from living in the city, the highly educated people that Levy and others want to bring to the city aren't paying those high rates. In fact, they are paying lower rates than those with low incomes. And second, it raises the question—to which our organization will return in future work—of whether our upside-down tax system is itself undermining economic growth and job creation in the city. After all, low-income Philadelphians spend all they earn, while high-income Philadelphians save some of their earnings. Reducing the taxes of low-income Philadelphians, rather than high-income Philadelphians, would thus lead to more immediate spending in the local economy and create jobs for people such as themselves.

The third reason not to be concerned about high average tax rates in Philadelphia is that there is little difference in the tax rates paid by city and suburban residents. This is important because, for years, those who have called for cutting taxes in Philadelphia have said that the main goal of the plan is to encourage people to live and businesses to locate in the city rather than the suburbs. However, Pew's research has shown that the tax gap between Philadelphia and its suburbs has been shrinking for 15 years. A middle-income family with a home in the city would pay 12.4% in state and local taxes and 11.6% in the suburbs, which is only .6% less. Again, the difference is likely to have an insubstantial effect on where individuals, families or businesses decide to locate. So many other factors—the quality of schools and access to the restaurants and cultural facilities in the city—are much more important.

That those other factors are more important is shown by an important piece of information Levy and Camp-Landis provide: there are 224,500 reverse commuters (Philadelphians who work in the suburbs). Instead of recognizing that every one of those 224,500 people rebut their claim that Philadelphia's taxes drive people out of the city, they seem almost incredulous that those people still live in the city. That they are incredulous indicates how much their way of thinking about our taxes is driven by ideology and not evidence. As we point out in the larger paper from which our column was derived, there is no evidence that taxes are a major determinant of where individuals live or businesses locate.

Much of the rest of the Levy/ Camp-Landis piece is an exercise in misdirection backed by barely relevant data.

First, they point out that Philadelphia has the highest wage tax in the country. But, historically, our property taxes have been low, and that is why our overall tax burden and tax rate is not much higher than the median city. For years, Levy has been claiming that making Philadelphia a more "normal" city with higher property taxes and lower wage taxes would stimulate business and population growth. But as we point out in our long paper, many economists and the experiences of San Francisco and Boston, which capped increases in assessments and reduced their reliance on property taxes, shows that the opposite is likely to be true.

Second, they point out that the data I presented on revenues includes other sources of revenues besides taxes, such as fees for city services and fines. This claim is just a red herring. Anyone who has worked in any capacity in public finance knows that cities often make choices between paying for services with fees or with taxes. Public transit in Philadelphia, and around the country, is paid for by both fares and an operating subsidy. Some cities, such as Harrisburg, charge homeowners a fee to pick up their garbage as well as requiring them to pay taxes. Some cities charge very little to park. Others charge a great deal and in doing so off-set some taxes. (It would not surprise anyone to learn that of the 30 largest cities, Philadelphia is third in parking fees per capita. And those parking fees provide support for our schools that in other cities are paid for by taxes.)

Thus there are two reasons to look at total revenues, not taxes. The first is that government services are provided by both taxes and fees and fines and if we want to look at the financial burden of living in a city we must include both. The second is that if we want to fairly compare the impact of government on the cost of living in a city, we need to look at the entire cost. It would be seriously misleading to conclude that a city that takes in less tax revenue but charges more for city services places a lower burden on businesses to locate there than a city that has the same overall level of revenues but has higher taxes and lower fees and fines.

Third, they employ data collected by Washington, DC, studies published annually by [the Office of the Chief Financial Officer of the District of Columbia] to justify their claim that our taxes are high. As we saw above, that data is useful for some purposes, such as examining the unfairness of Philadelphia's tax system. But it doesn't deal directly with the question of Philadelphia's local taxes compared to that of other cities. It includes state and local tax revenues, not just local tax revenues. And it appears that the local tax data included in the Washington study do *not* include county taxes for cities that are embedded in counties. This is the same flaw I found in the Pew report. (I should say that I'm not absolutely sure about this as the methodology section of the DC report does not clearly address this question.) Finally, the study doesn't look at the largest cities in the country but at the largest city in each state, which leaves out many large cities that should be compared to Philadelphia. Including them would likely raise the median and mean tax rates and lower Philadelphia in the ranking.

Fourth, in their effort to find some empirical evidence to support their ideology, Levy and Camp-Landis point out that more middle-class people have been leaving the city than coming to it. That is true—but only since the pandemic began. Philadelphia's population was growing—as the extraordinary pace of housing development in gentrifying neighborhoods shows. And while Philadelphia did indeed lose population during the pandemic, so did most major cities, especially on the coasts. Philadelphia did better than most of them. Twenty-six large major metro areas had a median population loss of 4.6%. The Philadelphia-Camden-Wilmington metro area ranked 18th among those 26 cities with a population loss of less than half as much—2.1%.

We don't know what the future will bring as businesses adjust to the current downswing of the pandemic and decide how much of their workforce to bring back to Center City and how often to do so. But that uncertainty about how many commuters Center City has or will lose doesn't give us the license to robotically assert that we are now in a "crisis" that can only be resolved by cutting taxes.

To begin with, we have no grounds to conclude that we are facing a permanent crisis. We don't know how many commuters from the suburbs or other city neighborhoods will ultimately be lost and how their loss would affect the city as a whole. We may lose enough commuters on a permanent basis that business activity will decline in Center City. But some of those commuters to Center City come from within Philadelphia itself, and we may well see increased business activity in outlying city neighborhoods because they are working at home. We also may eventually see a rebound in Center City business activity as rents decline or due to a continuation of the long-term trend of office buildings being converted to housing.

Whatever the future has in store for the city, the idea that cutting taxes can make up for major social trends like the rise in remote work is, frankly, ludicrous. In deciding whether to bring employees back to work in Center City, and how often to do so, businesses have to weigh the consequences of different remote working arrangements for their productivity. And they have to estimate how much money shrinking their office footprints will save them. These are major considerations that could have substantial costs and benefits for businesses. When the BIRT amounts to no more than .8 to 1.8% of all costs for Philadelphia-based businesses, there is no way that tax cuts can be more important than other factors in determining whether businesses ask their workers to work remotely or in Center City. And when the difference in taxes paid by suburbanites who work in their home county and those who commute to Philadelphia is only 1.9 percentage points, there is no way that the impact of taxes on the wages these businesses pay their employees will change those decisions either.

Thinking that minor changes in taxes can offset a major economic transformation that leads to far more remote work (if in fact such a transformation is more than a short-term blip) is similar to the error that the proponents of tax cuts have continually made. They look at the loss of jobs in Philadelphia in the second half of the 20th century and conclude that tax-rate changes are the culprit—not white flight, not redlining, not the development of interstate highways, not the transformation in manufacturing, not the flight of businesses to the South or abroad, not rising crime rates and not failing schools that led to a decline in jobs. They similarly look at the gains in population in the first two decades of the 21st century and again conclude that is tax-rate changes—not the growth in business services, education, and health care and not the growing appeal of urban life that led to a revival.

Stated so boldly, I hope it's clear that the claims of the proponents of tax cuts vastly overstate the importance of taxes in the location decisions that businesses and families must make. Economies are far more complicated than tax rates, and so is life. And if we don't understand that, we will keep offering the same bad economic development advice instead of focusing on how the city can generate more jobs and a growing economy in a way that reduces rather than increases economic inequality.

Response to Elinor Haider

I can more briefly respond to Elinor Haider criticism of my column. Like Levy and Camp-Landis, she criticize me for evaluating cities by using "own source revenue" rather than tax revenue.

I explained above why it makes more sense to use "own source revenue" than tax.

But more importantly, the real difference between my analysis and that found in the Pew report I criticize, has absolutely nothing to do with whether one evaluates tax burden using "own source revenue" rather than tax revenue.

The issue I raised was that, after carefully explaining why one can't fairly compare the tax burden of different cities by using data that does not account for revenue raised for local spending of the counties in which many cities, but not Philadelphia, embedded, Pew used the wrong data—*by its own standards.*

If one uses the most Lincoln Institute data, for 2017, and looks at taxes instead of revenue, Philadelphia ranks as the 10th highest taxed city, not the 6th highest as [Pew claimed].

As I said in my original piece, the Lincoln Institute database is not easy to understand and thus the error in the Pew report is certainly understandable.

But I don't understand and find difficult to grasp is how, once I've pointed their error out to them, a representative of Pew "stands by" a report that is not only wrong but has been used to advance a political objective.