THE POLICY PAGE

An Update on State and Federal Action

Center for Public Policy Priorities

900 Lydia Street, Austin, Texas, 78702 PH: 512.320.0222 FAX: 512-320-0227 www.cppp.org

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WHY YOU SHOULD CARE NOW ABOUT A SPECIAL SESSION ON SCHOOL FINANCE

Any meaningful school-finance reform unavoidably involves tax reform. The tax system established in a special session could determine the size of state budgets for the next ten years or more.

The governor and legislative leadership have declared their intention to hold a special session on school-finance reform next spring. **Groups that normally are not concerned with public education must not ignore this session.** Public education accounts for 42% of state general-revenue spending—as much as health and human services and higher education combined! Any significant change in school finance must therefore involve significant changes in the state tax system. The tax system that emerges from a special session would determine how much general revenue the state will have available to spend on all other state services for years to come.

Groups and individuals concerned with the state budget must start preparing for a potential special session on school finance now. Gov. Perry has stated that he will not call a special session until there is already an agreement on a school-finance plan. The House Select Committee on Public School Finance has been meeting since May; the Joint House-Senate Select Committee started meeting in August. If you wait until the session starts to try to influence the changes in the tax system, you will be too late.

CPPP has established a separate mailing list for detailed background information on the state/local revenue system and updates on proposals for tax reform. This is the first in that series. If you would like to join this list, please send an email to taxreform@cppp.org

THE TAX SYSTEM CANNOT KEEP UP WITH THE NEED FOR STATE SERVICES

A major failing of the Texas state and local tax system is its inability to keep up with the growth in the need for public services, creating a "structural deficit."

A tax system should be able to grow with a state's economy, generating additional revenue without increases in tax rates. Over the past decade, the Texas tax system has consistently failed to keep up with economic growth.

Since 1991 state and local tax revenue has fallen steadily as a percentage of statewide personal income—a standard measure of the size of a state's economy. Personal income reflects the ability of Texans to pay taxes. Growth in personal income also mirrors a growing need for public services, since it is in part a result of growth in population and inflation.

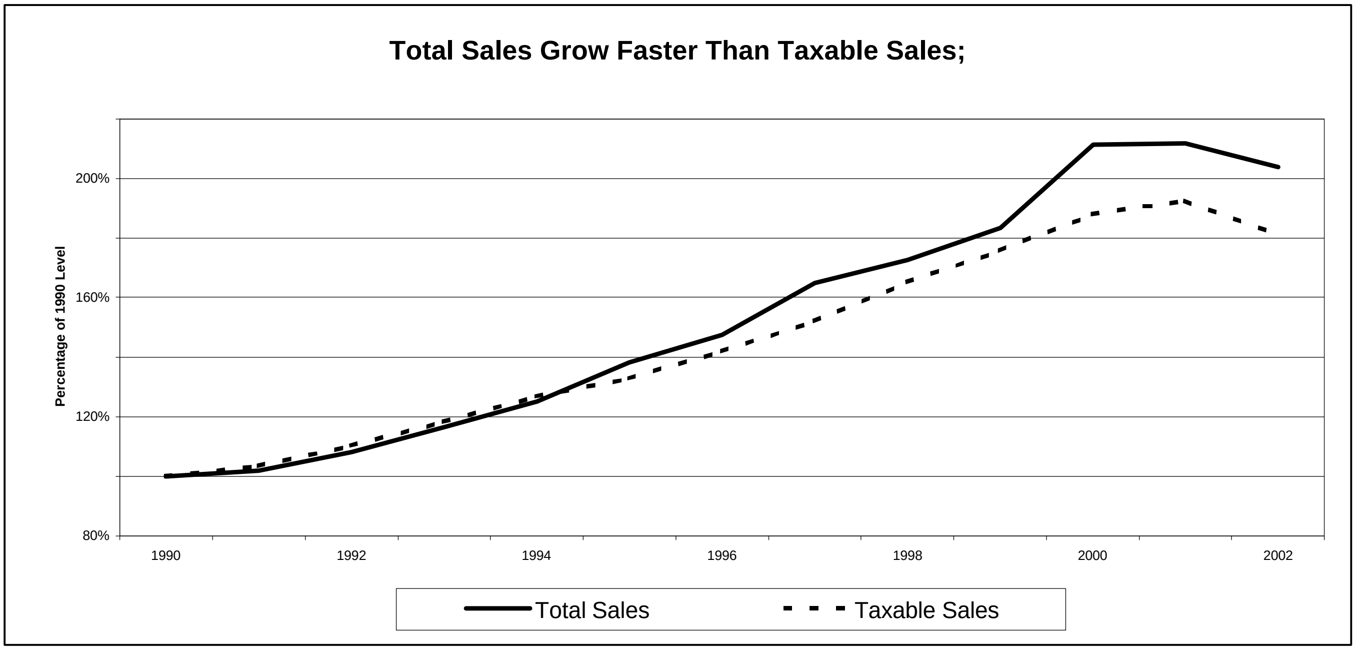
If tax collections had remained at their 1991 proportion of personal income, the state would have had an additional $15 billion in revenue to spend in 2004-05—completely avoiding this year's budget crisis and service cutbacks.

A major reason that the tax system cannot keep up with economic growth is its heavy dependence on the sales tax, which supplies more than half of all state tax revenue. Over time, as the chart at the top of the next page shows, the sales tax has applied to a shrinking percentage of all sales transactions in the state. Total sales has grown faster than taxable sales.

Partly this reflects untaxed Internet and mail-order sales, but the larger problem is that the sales tax has not changed along with changes in the nature of the economy. Texas adopted a sales tax in 1961, which most sales involved goods—tangible items. However, in the modern economy, the faster growing sectors involve services rather than tangible goods.

TEXAS TAXES ARE VERY UNFAIR

Not only does the Texas tax system fail to generate enough money to meet the state's need; it raises this money in a very unfair way. The Texas tax system places the heaviest burden on those least able to pay. Texas taxes are regressive, meaning they take a much greater percentage of the income from a low- or moderate-income family than from a higher-income family. Texas' state and local tax system is the 5th most regressive among the 50 states.



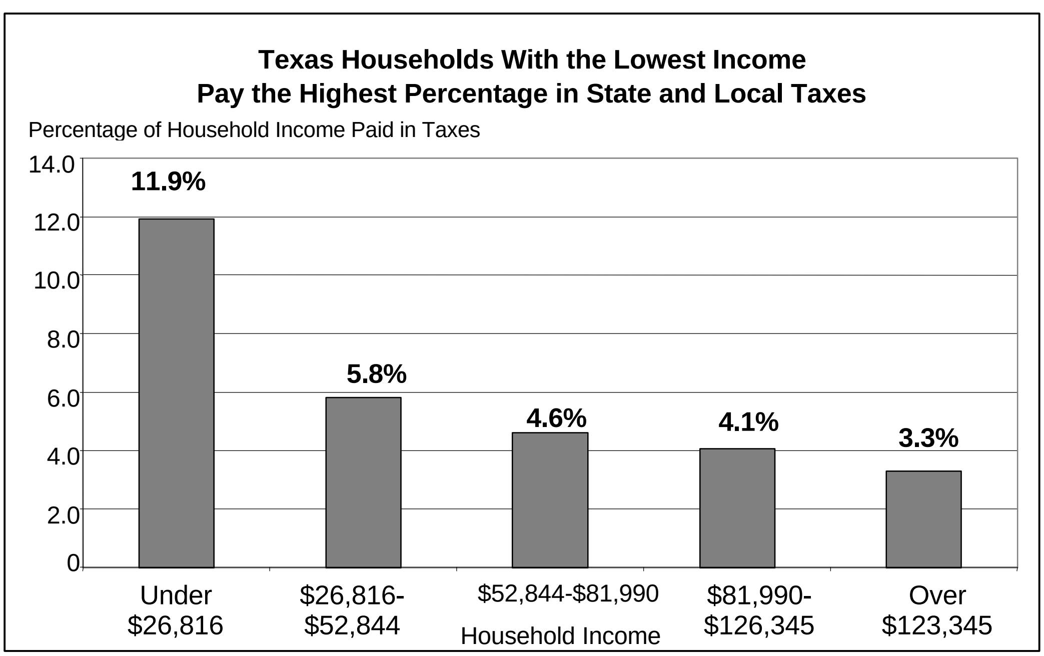
To see how regressive Texas taxes are, see the chart below, which shows state and local taxes as a percentage of household income. A household in the lowest income bracket has almost 12% of its income going to state and local taxes, while the highest-income households spend only 3.3% of their income on state and local taxes.

The reason for this regressivity is the state heavy reliance on the sales tax, which is based on consumption. Consumption taxes are extremely regressive, because lower-income families spend all of their income (and sometimes more, by going into debt), while higher-income families can afford to buy all they need and still have money left over. For instance, an average family with an income under $26,800 pays 4.2% of that income in sales taxes, while a family with an income over $126,300 pays only 1.1% of its income in sales taxes.

TAX REFORM MAILING LIST

Substantive tax reform is a rare event. Any new system created in a special session would determine how much money would be available for public services for at least the next decade. It is therefore vitally important that all the needs of the state, not solely public education, be considered in designing a tax plan.

CPPP has created a new mailing list, separate from the *Policy Page* list, to prepare for the possible special session on school finance and to disseminate information about tax reform. The goal is to create a fair tax system that generates enough money to meet the state's needs. To join this list, please send an email to taxreform@cppp.org



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