



THE TEXAS BUDGET & TAX PRIMER

Where the State's Money Comes From
&
How It is Spent

August 2002



Center for Public Policy Priorities

Center for Public Policy Priorities

The CPPP is a non-partisan, non-profit policy research organization seeking sound solutions to the challenges faced by low- and moderate-income Texans.

The Center is committed to improving public policies and private practices that influence the economic and social conditions and prospects of individuals, families, and communities.

The Center pursues this goal through independent research, analysis, policy development, advocacy, public education, technical assistance, and building collaborative partnerships.

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What Exactly Is the State Budget?

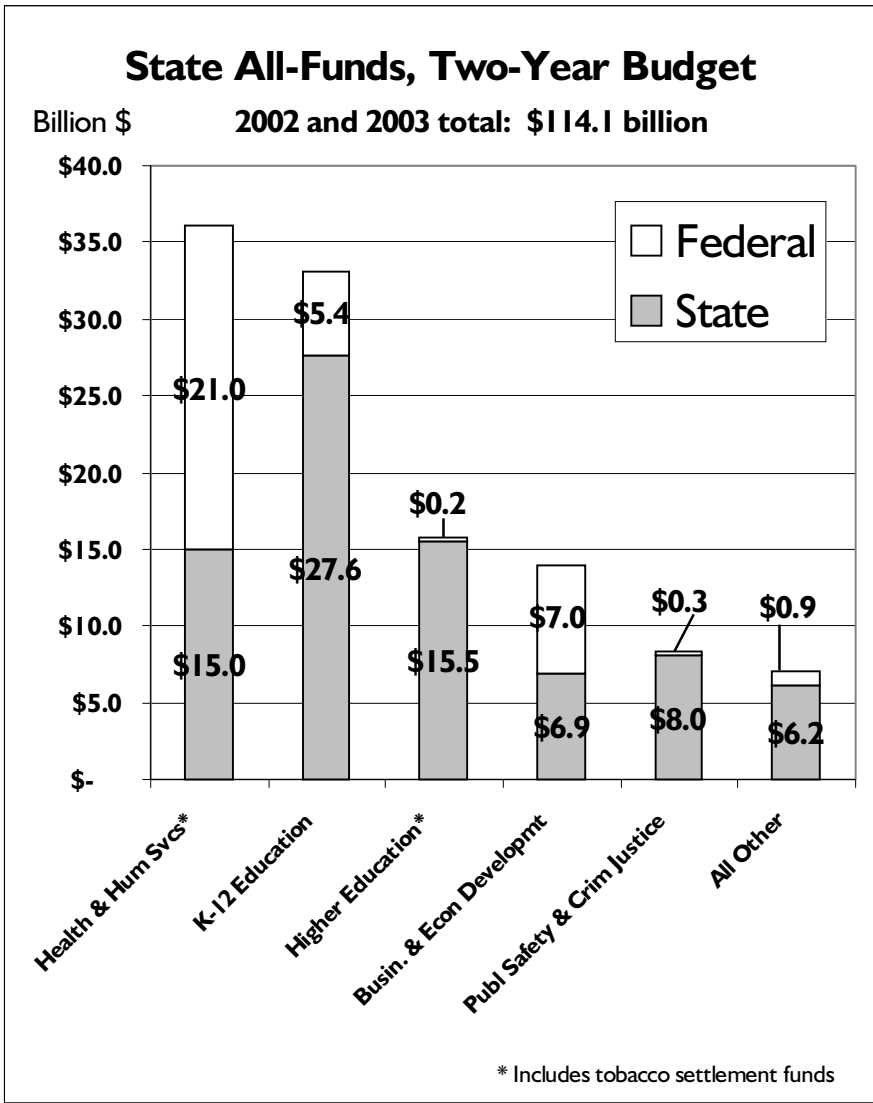
The “state budget” for Texas is the General Appropriations Act, which the Legislature must enact every two years in order for state government to continue operating.

The 2001 legislature passed a General Appropriations Act and other legislation which spent \$114.1 billion in “All Funds” for 2002 and 2003. “All funds” includes: \$61.5 billion in General Revenue; \$5.4 billion in General-Revenue dedicated funds; \$34.8 billion in federal funds; and \$12.4 billion in other funds such as the State Highway Fund, trust funds, bond proceeds, and interagency transfers. The chart at left shows intended spending by major functions—the different “Articles” of the Appropriations Act. (“All Other” in the chart includes Judiciary, Natural Resources, Regulatory, Legislature, and General Provisions.)

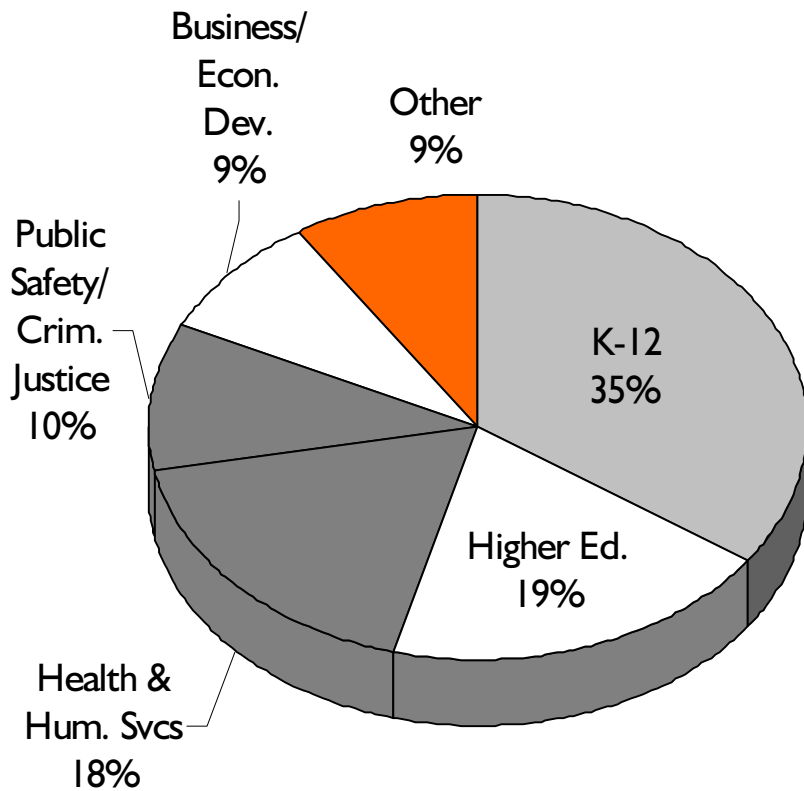
The 1,002-page Appropriations Act for 2002-03, Senate Bill 1, is at http://www.lbb.state.tx.us/Bill_77/5_Final/Bill-77_5.htm

The General Appropriations Act, which is prepared using performance-based budgeting linked to a state strategic plan, has “goals” and “strategies” for each state agency and higher education institution. Appropriations are usually made at the strategy level, and outcome, output, and efficiency indicators may also be found in the Appropriations Act, providing additional information about the appropriated levels of spending.

Some basic and important questions to ask about state budget proposals include: “Is that an All Funds cost, or General Revenue only?” and “Is that a biennial cost, or a one-year cost?” The first question is especially important in Health and Human Services (HHS), where General Revenue often (but not always) can draw down additional matching federal funds.



2002 & 2003: \$79.3 billion in non-federal spending by state agencies



How is State Money Spent?

When the state’s “own” money is defined as everything except federal funds—the \$114.1 billion in All Funds for 2002-03 minus \$34.8 billion in federal funds, or \$79.3 billion in nonfederal appropriations —the allocation of state dollars looks somewhat different (see chart at left). In 2001, legislators enacted a budget that devotes more than one-third of the state’s “own” money to **public K-12 education**-35 cents out of every state dollar spent. Another 19 cents goes to **higher education**. That’s more than half of every state dollar spent right there.

Next come **health and human services** (18 cents), **prisons and public safety** (10 cents), and **business and economic development** (including **highways**, which get about 9 cents of each state dollar). After paying for those basic services, only 9 cents are left for things like environmental protection and state parks, state courts, and everything else the state funds directly or through local governments.

Decisions about changing the state’s budget priorities are difficult not just because so much state funding is currently going to basic services like education, but also because of the many “strings” attached to how state dollars can be spent. For 2002-03, the state plans to spend \$47.2 billion in federal funds and Other Funds. Flexibility in spending these dollars is very limited.

That’s why most of the state budget process hinges on how General Revenue is spent—but even GR spending is not completely discretionary. The Legislative Budget Board estimates that almost 83% of the \$66.8 billion state GR and GR-dedicated funds are spent in accordance with the state constitution or state law (45%); a federal law, regulation, or a court decision (24%), or a formula (13%). In 2002-03, this meant that \$55.4 billion was “restricted appropriations”, compared to only \$11.4 billion in “unrestricted” spending-or 10% of All-Funds spending.

HOW THE FISCAL 2002-03 TEXAS STATE BUDGET WAS WRITTEN

Planning	<p>May 2000: Budget Instructions Issued by Legislative Budget Board (LBB) and Governor's Office of Budget and Planning</p> <p>June: Agencies Submit 5-Year Strategic Plans</p> <p>July to August: Agencies Submit 2-Year Budget Requests</p> <p>August to September: LBB/Governor Hold Budget Hearings</p>
Formation	<p>January 2001: Comptroller releases Revenue Estimate</p> <p>January 2001: LBB and Governor Issue Budget Recommendations to 77th Legislature</p> <p>January 2001: Draft Budget Bill Introduced</p> <p>January-May: Legislators Mark Up and Approve the Appropriations Bill</p>
Approval	<p>June 2001: Appropriations Bill is certified by Comptroller and Approved by Governor</p>

What Else Determines How State Money is Spent?

Texas is one of only seven states with a biennial legislature and a biennial budget process. In odd-numbered years, legislators convene in Austin to pass the two-year General Appropriations Act and many other bills that influence state and local spending of taxpayer dollars. However, as the chart at left shows, the legislative phase of the budget-writing process is only one part of a multi-step cycle.

The state officials with the most influence on the Appropriations Act are

- (1) the Comptroller of Public Accounts, who gives legislators an estimate of how much revenue they can spend;
- (2) the Legislative Budget Board (LBB), which receives and holds hearings on budget requests from agencies and develops draft recommendations for the "base" budget introduced in January;
- (3) the members of the House Appropriations and Senate Finance Committees, who hold hearings on the draft budget bill and mark it up before approval by the full House or Senate,
- (4) the House-Senate Conference Committee on the appropriations act, whose members hammer out a compromise budget that both chambers will approve; and
- (5) the Governor, who can also make budget or tax proposals, but tends to have more influence at the end of the process through vetoes of line items in the appropriations act or vetoes of other bills. (The Governor's office also issues the budget instructions and holds budget hearings together with the LBB at the beginning of the budget cycle.)

Ranking of Texas' Spending, State Vs. State and Local

STATE	STATE & LOCAL
50th in overall state spending	43rd in overall state and local spending
15 th in hospital spending (incl health science ctrs)	10 th in prison spending
17 th in prison spending	15 th in hospital spending
37 th in education spending	26 th in education spending
42 nd in highway spending	31 st in interest paid on general debt
43 rd in natural resources protection	32 nd in law enforcement (police)
44 th in interest paid on general debt	38 th in natural resources
45 th in public health	38 th in govt. employee wages and salaries
46 th in public welfare and Medicaid	39 th in public health programs
48 th in parks and recreation	40 th in parks and recreation
49 th in law enforcement	45 th in public welfare and Medicaid
50 th in general government admin. (including courts)	46 th in roads and highways
50 th in govt. employee wages and salaries	50 th in general government admin.

How does Texas' spending compare to other states?

When spending by state government alone (including federal funds spent by state agencies) is compared, Texas ranks dead last in per capita terms—about \$2,470 per Texan in 2001.

A more complete picture compares state AND local governments' (school districts, cities, counties, special districts) spending per capita. On this score, Texas ranks 43rd nationally, with \$5,005 in total spending per capita in 1999.

Isn't it possible that Texas spends less because its residents *need* less government?

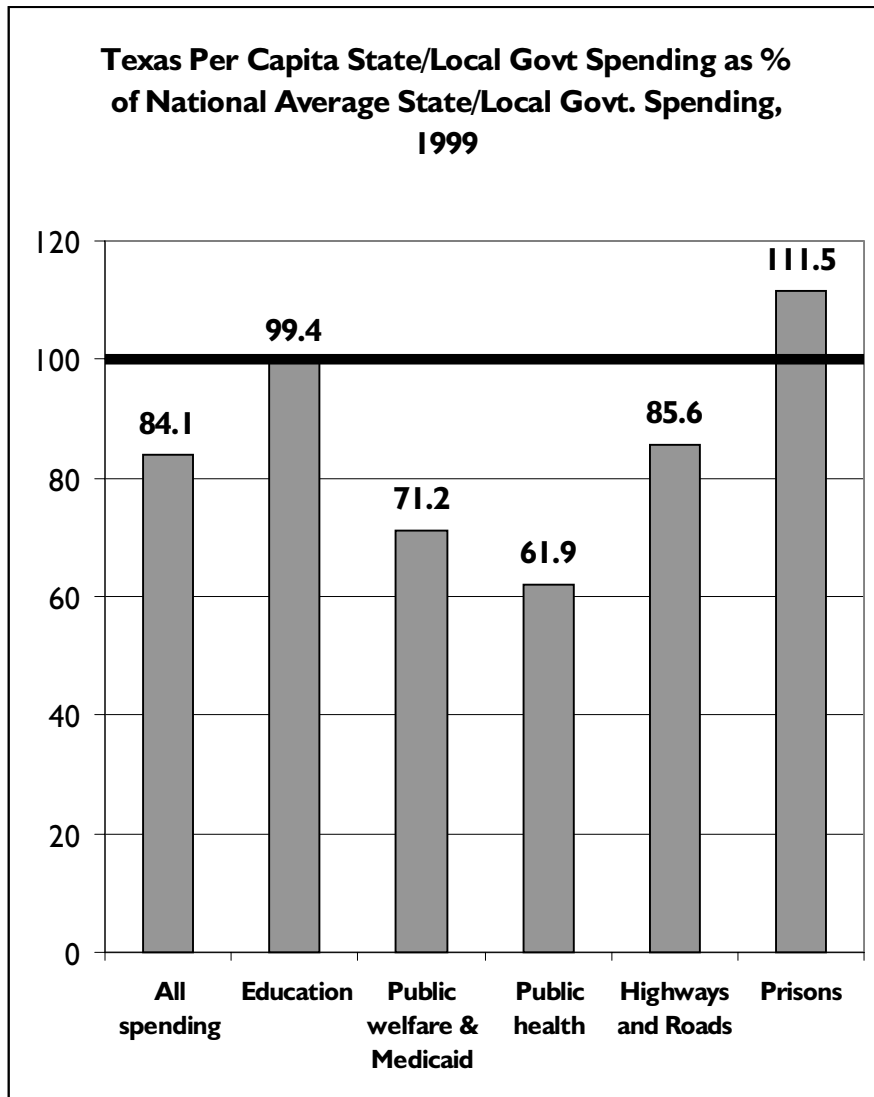
Actually, Texas is a high “need” state for several reasons:

- It has a very large proportion of children so it requires more spending on public education
- Many Texans live in poverty, even with a full-time job
- A high percentage of Texans lack health insurance

How much would it take for Texas to be “average” in spending?

Combined, Texas state and local governments would have had to spend almost \$19 billion more in 1999 for the state to be 25th in per capita spending. Just to get Texas up to the U.S. average would take:

- \$4.6 billion more for Medicaid, cash assistance, and other social welfare programs
- \$1.3 billion more for public health
- \$983 million more for highways and streets
- \$625 million more for parks and recreation
- \$616 million more for housing & community development
- \$611 million more for judicial and legal spending
- \$426 million more for natural resources and environmental protection programs
- \$199 million more for education (NOTE: This would get Texas up to the U.S. average in *per-capita* spending; to reach the U.S. average in state K-12 aid *per pupil* would require an additional \$3.4 billion.)
- \$31 million more for public transit subsidies.



What About Taxes?

What Taxes Do We Pay?

This chart looks at taxes from the point of view of the taxpayer – what taxes does the average Texas family pay?

More than three-quarters of all state and local taxes paid by Texas taxpayers go to just two taxes – the property tax and the sales tax.

The property tax is the largest tax paid by the average Texas family. About 60% of property taxes go to support local school districts; the rest goes to cities, counties, and special districts (community colleges, hospital districts, water districts, etc.).

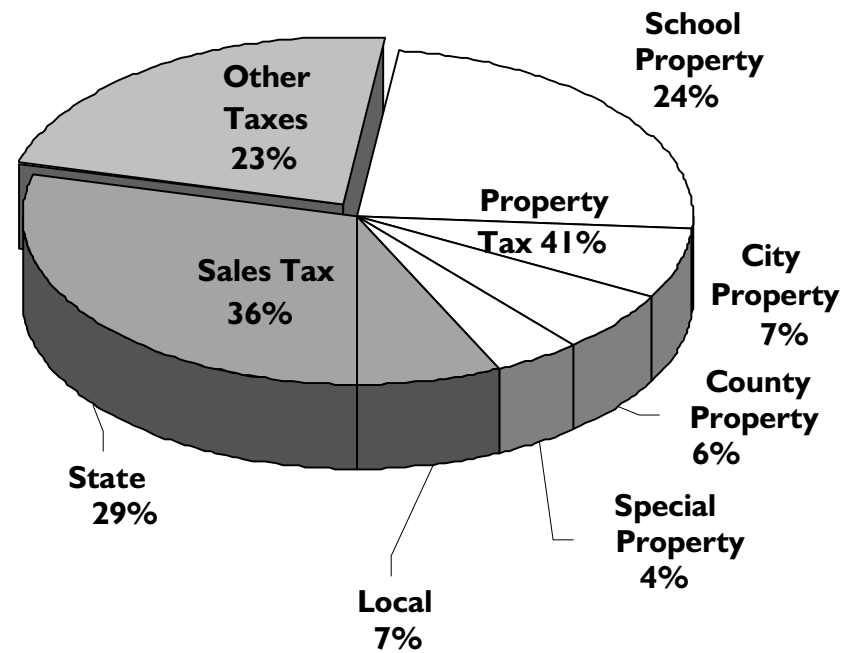
The state sales tax (6 ¼% statewide) accounts for most sales taxes collected. Cities, counties, transit authorities, and other local taxing units may levy a sales tax of up to another 2% combined.

All other state and local taxes, including the motor-vehicle sales tax, corporate franchise tax, and taxes on gasoline and alcohol, make up less than one-quarter of all state and local taxes paid in Texas.

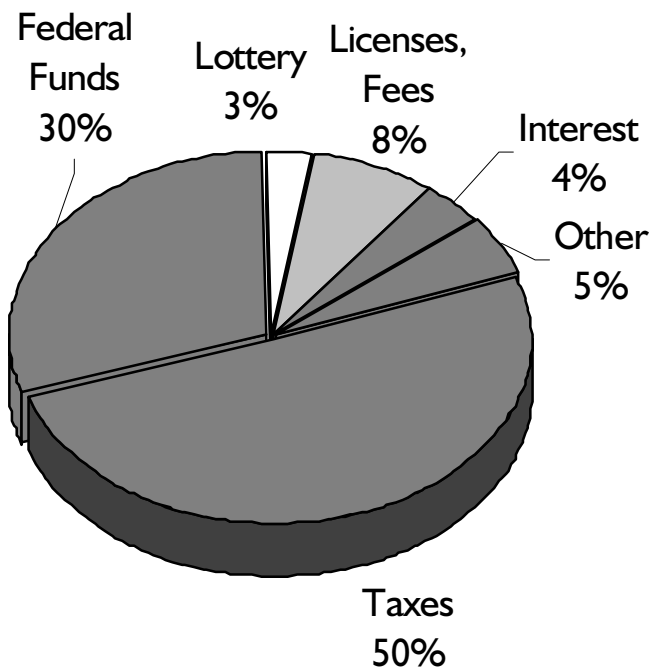
Texas' dependence on just two major taxes has distorted the state and local tax system. Although Texas has a very low total state and local tax burden (\$2,456 per capita in fiscal 1999, 39th among the 50 states), it ranks 9th in sales taxes per capita (\$1,248) and 16th in property taxes per capita (\$938).

Looking at it another way: Texas has a very low state tax burden – 49th of the 50 states in state taxes per capita. But the need to fund services like public education does not disappear; it just gets shifted to local taxes. Texas ranks 14th in local taxes per capita.

State and Local Taxes in Texas, 2001



State Revenue Sources, 2001



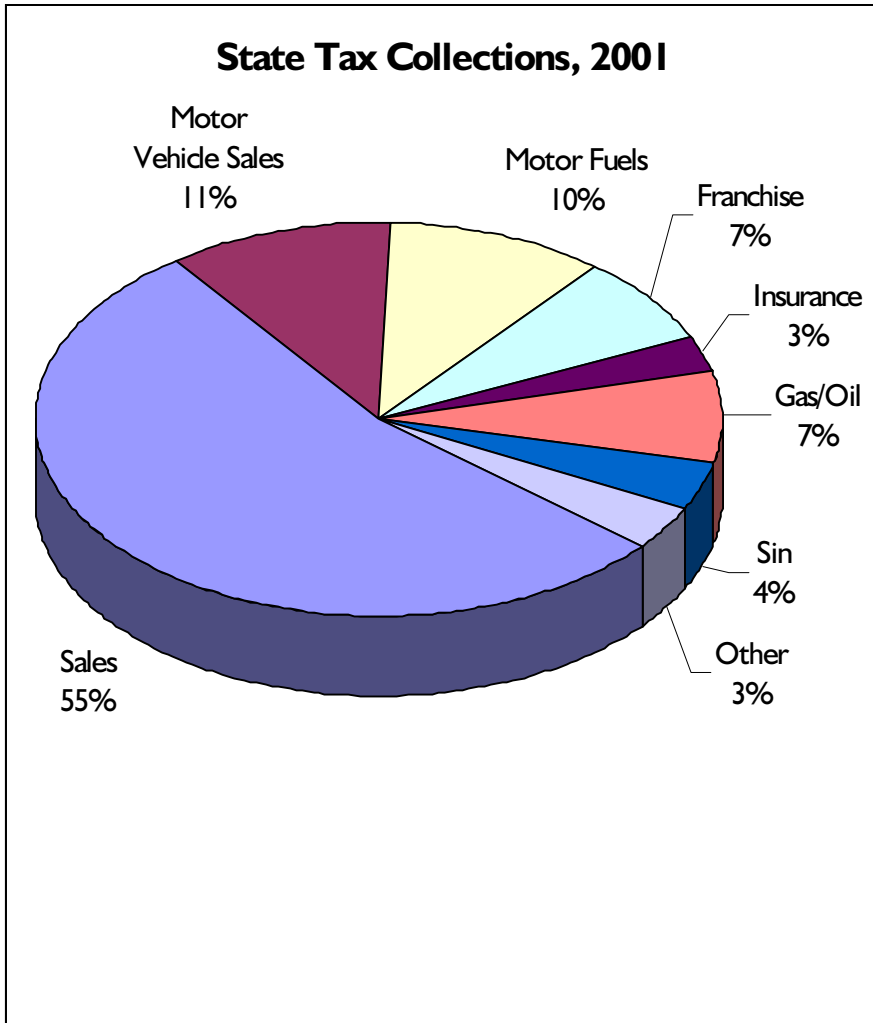
Where Does the State Get Its Money?

Now let's look at revenue from the state's point of view – where does state government in Texas get its money?

Half of the state's revenue comes from taxes (\$27.2 billion in 2001).

Another 30% of state revenue comes from the federal government. The largest programs receiving federal money are Medicaid and the highway fund.

The state lottery generates only 2.6% of all state revenue. In 2001, the lottery produced \$1.4 billion for the state, down from \$1.9 billion in 1997. Lottery proceeds are dedicated to public education.



What Taxes Does the State Collect?

This chart shows the one-half of state revenue that comes from taxes:

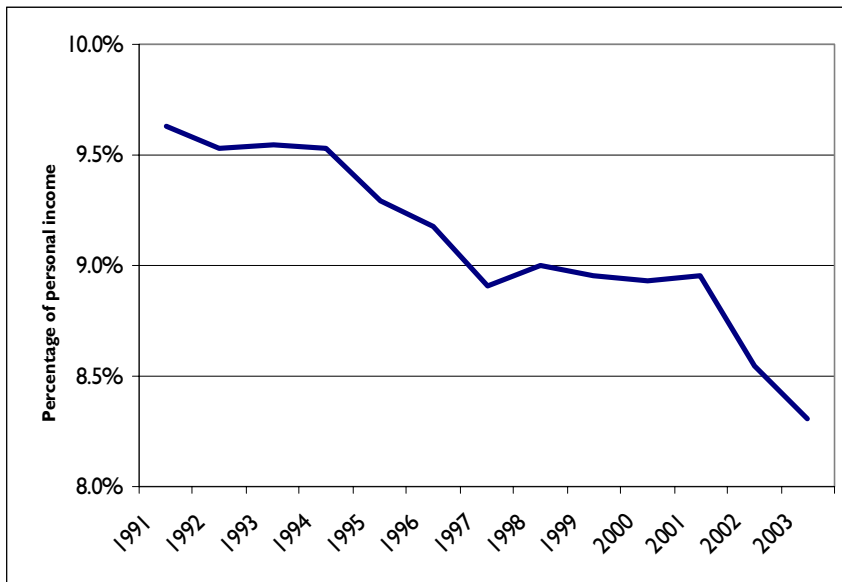
The state is heavily dependent on the sales tax, which supplies 55% of all state tax revenue. The sales tax has produced the majority of state tax revenue every year since 1988.

The motor-vehicle sales tax, which is technically a separate tax from the general sales tax, is the second largest source of state tax revenue.

Sales taxes and other taxes linked to consumption – the motor-fuels tax on gasoline and diesel, and “sin taxes” on cigarettes and alcohol – account for 80% of state tax revenue.

Taxes initially paid by business, including the corporate franchise tax, the tax on insurance premiums, and other taxes, provide the rest of state tax collections.

State and Local Taxes as a Percentage of Personal Income



How are State and Local Taxes Changing Over Time?

A major failing of the Texas state and local tax system is its inability to keep up with the growth of the state.

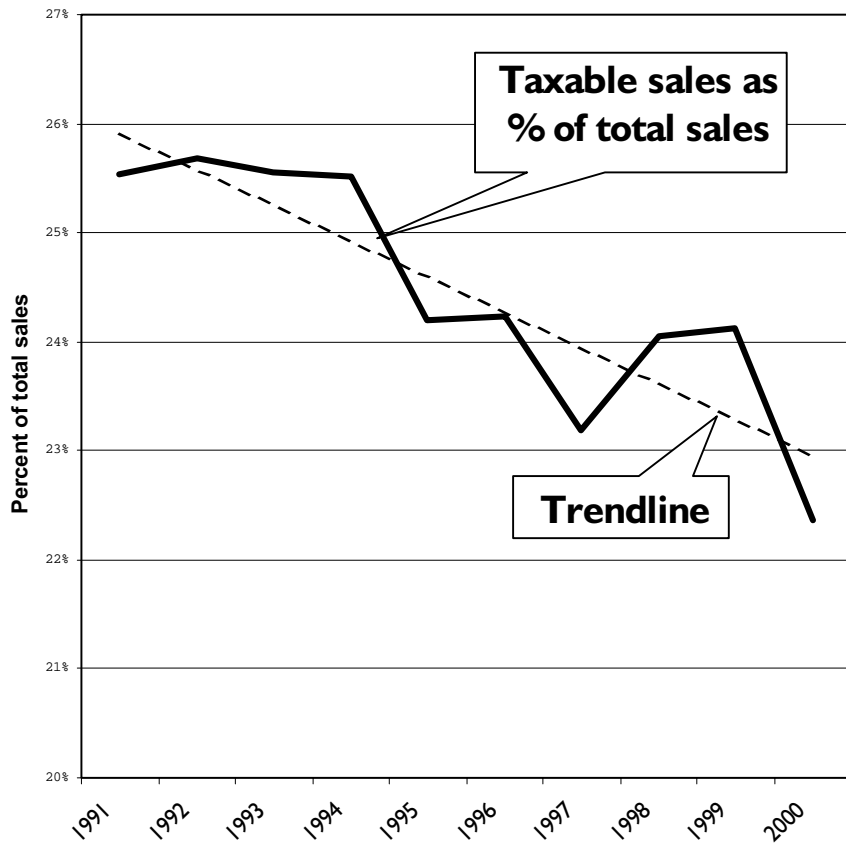
A good tax system should be able to grow with the state's economy, generating additional revenue without increases in tax rates. The Texas tax system has consistently fallen behind economic growth over the past decade.

In the economic bust of the late 1980s, many tax rates were increased to help support state programs. For instance, the state sales tax rate was raised from 4¼% in 1984 to 5¼% in January 1987, 6% in October 1987, and to the current rate of 6¼% in 1990.

Since 1991, state and local tax revenue has fallen steadily as a percentage of statewide personal income – a common measure of the size of a state's economy.

Although state tax rates have not increased, local school districts have raised school property tax rates consistently over this period. The statewide average school tax rate was \$1.06 in 1990; \$1.49 in 2001.

Taxable Sales as a Percentage of Total Sales

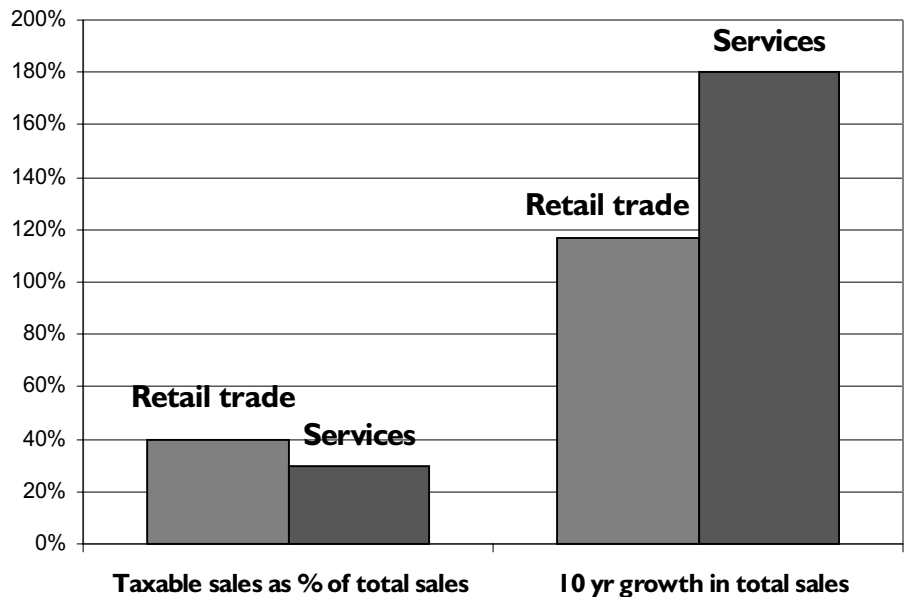


How Are State Sales Tax Collections Changing Over Time?

A major reason that the Texas tax system cannot keep up with economic growth is its heavy dependence on the sales tax.

Over time, the sales tax has applied to a shrinking percentage of all sales transactions in the state. Sales volume has grown faster than sales tax receipts.

Sales Tax Captures Less of Services Than of Retail Trade; Services Sectors Grow Faster



Why Isn't the Sales Tax Keeping Pace with a Changing Economy?

Texas adopted a sales tax in 1961, when most sales involved goods – tangible items.

However, in the modern economy the fastest growing sector involves services – actions, rather than items.

The sales tax applies to 40% of retail trade in goods, but only 30% of the sales of services. Over the past ten years, sales of services have grown at a pace one and one-half times faster than the growth in retail trade in goods.

The state could generate additional revenue by expanding the sales tax to cover services that are currently untaxed, including most business and professional services.

The Comptroller has estimated that taxing services (except medical and dental services) could raise \$3.2 billion a year.

Cost of Tax Cuts on State Budget

Tax cut	2002-03 cost (in millions)	% of total
Homestead exemption	\$1,284	49%
10% cap on appraisal	\$312	12%
Over-the-counter drugs	\$299	12%
R&D	\$266	10%
Investment credit	\$116	4%
Small business	\$98	4%
Sales tax holiday	\$69	3%
Job creation	\$58	2%
Data services	\$39	1%
Internet access	\$28	1%
Timber	\$12	< 1%
After-school care	\$11	< 1%
Child care	\$10	< 1%
TOTAL	\$2,600	100%

How Much Have Recent Tax Cuts Reduced State Revenue?

In 1997 and 1999 the Legislature passed a number of tax cuts that received a great deal of public attention.

The largest single tax cut was the 1997 increase in the statewide homestead exemption for school property taxes from \$5,000 to \$15,000. Because the state guarantees school districts a certain amount of revenue for each penny of tax effort, and because a greater exemption reduces the amount of local revenue generated at any tax rate, the increased local exemption increases the state's cost, reducing state revenue available for other programs. The increased homestead exemption cost the state \$1.3 billion in 2002-03 – half of the total revenue lost to tax cuts.

The 1997 Legislature also limited the amount by which the taxable value of a homestead can increase to 10% a year. Like the homestead exemption, this cap reduces local school tax revenue, so it increases the state's cost. This provision reduced state revenue available for other purposes by \$312 million in 2002-03.

The sales tax has never applied to prescription drugs. However, many families cannot afford to visit a doctor to obtain a prescription for medicine. In 1999 the Legislature exempted over-the-counter drugs from the sales tax, at a cost of almost \$300 million in 2002-03.

These three exemptions account for three-quarters of the revenue lost to the 1997-99 tax cuts. However, it would not be advisable to attempt to reverse these cuts to increase state revenue. These provisions increased the fairness of the state and local tax system and are very popular with taxpayers.

Why Do People Say the Sales Tax is an “Unfair” Way to Raise Money?

A second major problem with Texas’ state and local tax system – in addition to its inability to generate adequate revenue – is its unfairness.

The Texas tax system takes a much greater percentage of the income from a low- or moderate-income family than it does from a higher-income family. This type of tax system is called “regressive.” By one recent measure, Texas’ state and local tax system was the 6th most regressive among the 50 states.

The main reason for this regressivity is the sales tax. The sales tax is based on consumption. Most families spend all that they earn each year (or more, by going into debt). But higher-income families are able to purchase everything they need and still have money left to save.

The sales tax exempts groceries, residential utilities (gas, electric, water), and medicines. But even with these exemptions for necessities, the sales tax by its nature is still regressive.

The Texas tax system places the heaviest burden on those who can least afford it. A fairer tax system would link tax burden to a family’s ability to pay, taking more from those who can afford the most.

