



Center for Public Policy Priorities

# THE POLICY PAGE

## Update on State and Federal Action

900 Lydia Street, Austin, Texas, 78702 PH: 512.320.0222 FAX: 512.320-0227 [www.cppp.org](http://www.cppp.org)

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## WHY ISN'T THERE ENOUGH MONEY?

*The current state budget squeeze was fueled in part by tax cuts enacted in 1997 and 1999 (see Policy Page #110). But there are also deeper structural problems with the Texas tax system that keep state and local revenue lagging behind economic growth. If tax revenues had been able to keep up with the growth in personal income since 1994, budget-writers now would have an additional \$9.8 billion available to appropriate for the 2002-03 budget. Another \$11.2 billion would have been available in 1995-2001.*

*For additional information, contact Dick Lavine at (512) 320-0222 or [lavine@cppp.org](mailto:lavine@cppp.org)*

A good state and local tax system should be able to provide an adequate amount of revenue—enough to cover spending needs. One measure of the adequacy of a tax system is its ability to keep up with the growth of total personal income in a state. Personal income growth reflects both inflation and population changes and roughly parallels the increase in the cost of providing the same level of services year after year. Personal income also reflects the ability of a state's residents to pay taxes.

Texas' state and local tax revenue has not kept up with personal income. In the early 1990s, after the tax-rate increases forced by difficult economic conditions, state and local tax revenue equaled a fairly constant 9.6 percent of personal income. But since 1994, tax revenue has fallen steadily as a percentage of personal income. By 2003, state and local taxes are projected to equal only 8.35 percent of personal income—only 7/8 of the relative income of 10 years earlier.

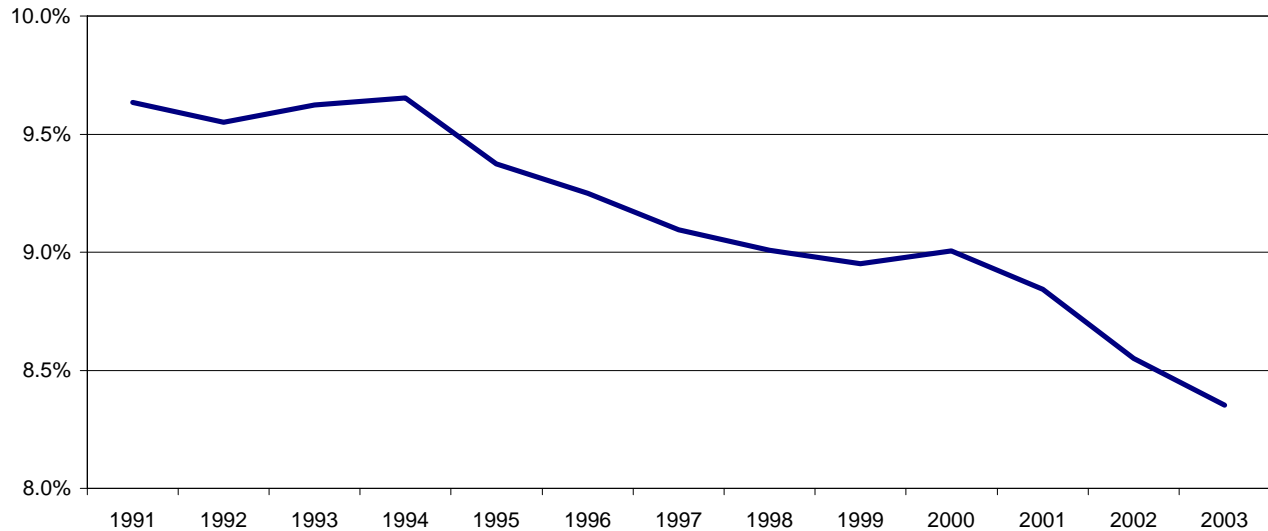
It is important to look at state and local tax revenue as a single system, since state spending on public education is directly linked to the ability of school districts to generate revenue from local property taxes. Cities and counties also are responsible for providing important public services. But viewing only state revenue by itself helps dramatize how much is lost because of the shortcomings of the Texas tax system.

If state tax revenue had remained at the same percentage of personal income as in 1994, state budget-writers now would have an additional \$9.8 billion available to appropriate in the 2002-03 budget. Another \$11.2 billion would have been available in 1995-2001.

Any analysis of the inability of Texas' tax system to generate enough revenue to fund basic needs must start with the state sales tax, which accounts for more than 55 percent of state tax revenue. The sales tax is primarily a tax on the sales of tangible items—things—while the recent growth in the economy is mainly in services, so the sales tax misses an increasing proportion of economic activity. The sales tax also misses the growing number of transactions carried out over the Internet. Texas needs a revenue source that can better keep up with the growth in the economy

During the current session, lawmakers can begin to address the inadequacies of our current tax system. One relatively simple idea is to examine the range of tax exemptions and exclusions to see if they justify the loss in revenue for needed services. Close review of such exemptions can help prevent future budget crunches by showing lawmakers the impact of their tax decisions today on the budgets of tomorrow.

## State and Local Taxes As a Percentage of Personal Income



Data: Annual Cash Report (various), Annual Property Tax Report (various), Biennial Revenue Estimate (2002-03), Fiscal Size-Up (2000-01)

Calculations by Dick Lavine, Center for Public Policy Priorities

Above: The last ten years have seen a consistent decline of taxes as share of personal income, projected to continue through 2003.

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### Additional State Tax Revenue Per Year If State Tax Revenue Had Remained at its 1994 Percentage of Personal Income

1995	\$0.50 billion
1996	\$0.90 billion
1997	\$1.14 billion
1998	\$1.60 billion
1999	\$2.16 billion
2000	\$2.13 billion
2001	\$2.78 billion
2002	\$4.32 billion
2003	\$5.48 billion
2002-03	\$9.80 billion

As a result, the state failed to collect billions in revenue that could have prevented the current budget battle.

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