

TAXING TEXANS:

A SIX PART SERIES EXAMINING TAXES
IN THE LONE STAR STATE

Texas Public Policy
F o u n d a t i o n

www.tppf.org

September 2002

PART FIVE:

Attracting New Jobs in Texas: Tax Burdens Compared to Other States by Richard Vedder, Ph. D.



8122 Datapoint Drive, Suite 326 • P.O. Box 40519 • San Antonio, TX 78229-1519

Executive Summary

Though Texas ranks near the bottom of all states in total tax burden on consumers, tax revenues are still higher than they've ever been. Where does Texas stand in relation to other states, both in levels of taxation and the services it provides taxpayers?

By the most accurate calculations (which take local jurisdictions into account), Texas' tax burden ranked 47th among the states. Six other states had tax burdens very similar (within six percent) of that of Texas: Colorado, Florida, Missouri, Nevada, Oregon, and Virginia. Several of these states compete directly with Texas, particularly for high technology business. Thus Texas is one of a group of 10 states (Alabama, Colorado, Florida, Missouri, Nevada, New Hampshire, Oregon, Tennessee, Texas, and Virginia) with a combined 60 million in population with a low or very low tax burden.

That low tax burden has helped to propel the Texas economy to high rates of growth. I examined three outside assessments of each state's business or fiscal climate, and did one of my own. Texas did very well in all four measures, and the median of all studies is a very respectable B+. Moreover, Texas generally receives higher marks than all of its neighbors, dramatically so in the case of New Mexico. While the state is graded substantially higher than one of its important Sun Belt competitors (California), it ranks below Florida, one of the best states in the Union on almost all fiscal evaluations.

Comparisons to other states also show that Texas, while spending slightly less than average on government, is nonetheless well in line with other states in the funding it provides to essential government services.

What can we conclude from our ranking? Take it easy and go slow—the Texas system is not in need of radical reform. What Texas needs instead are moderate changes designed to make the Lone Star State even more attractive to individuals and businesses.

Spending and Tax Burdens: Texas and the U.S.

No one doubts that Texans are paying more than ever in taxes. Estimated state tax collections in fiscal year 2001 were more than eleven times as large as they were in fiscal year 1972. Tax revenues have grown at a compounded annual rate of 8.87 percent over the past 29 years.

But where does Texas stand in relation to other states, both in levels of taxation and the services it provides taxpayers. Is the tax base growing or shrinking? Is the present system of taxation pro-growth or will it hinder economic expansion? Do Texans get more bang for their buck in terms of government services?

State and Local

In answering these questions, it's critical to include local governments in the analysis, since local government makes up such a varied amount of the funding mix in different states. In Hawaii, for example, there is one school district for the entire state. From state to state the role of state government in funding schools, roads, and other improvements can vary significantly.

The most authoritative and comprehensive data on state and local finances is gathered by the U.S. Bureau of the Census in the Department of Commerce. Unfortunately, the numbers are published with a considerable time lag. Table 1 compares Texas with the United States average on several key fiscal measures. There are two ways of making comparisons: using per capita tax (or other revenue source) collections, or by taking those collections for each \$1,000 of personal income. The latter measure is generally considered the better measure of tax burden, as it provides a measure of the proportion of personal income taken in state and local taxes.

Table 1

**State and Local Government Revenues Per \$1000 Personal Income:
Texas Vs. the U.S. Average, FY 1999**

Revenue Source	Texas	U.S. Average	% Texas Below the U.S. Average
Total Revenue	\$231.00	\$242.98	4.9%
General Revenue	177.59	194.22	8.6
General Revenue from Own Sources	142.82	157.56	8.4
Taxes (Total)	96.79	110.42	12.3
Fees and Charges	26.23	28.56	8.1
Miscellaneous Gen. Revenues	19.80	18.58	-6.6
Other Own Source Revenues	38.67	58.77	34.2
Federal Grants	34.77	36.65	5.1

Source: U.S. Bureau of the Census, Author's Calculations

Total Revenue

This item reflects all revenue collections of governments, including those received by such business operations as hospitals, utilities, and, in some states (but not in Texas) liquor stores. More than 23 cents of each dollar earned by Texans (or \$231 of each \$1000) was taken by state and local governments in fiscal year 1999 — which sounds high enough, but is actually about five percent below the U.S. average.

General Revenue

For most purposes, general revenue is a better measure of the government's burden on the population, as it excludes utilities, state liquor stores, and insurance trust funds for public employees. In Texas, about 18 cents out of each dollar earned is taken by government by this measure, compared with about 19 cents nationally. So Texas is below the national average, but not dramatically.

General Revenue from Own Sources

This item is general revenue, described above, minus federal grants-in-aid. This is an even better measure of the extent to which Texas governments reduce the income of the people. Note that more than 14 cents per dollar is taken by Texas governments, about 8 percent less than the national average.

Taxes

This is the item most cited in comparing the governmental burden of different states. Taxes are levies on the population to finance general government services, unlike other revenue sources that are associated with use of governmental services (such as fees and charges) or federal grants. Texans currently are “rendering unto Caesar” about one-tenth of their income in taxes. In this respect, Texas’ overall tax burden is 12 percent below the national average, although the inclusion of federal taxes would likely narrow the differential between Texans and other Americans.

Fees and Charges

Some governmental activities are financed according to the benefit principle of public finance, whereby those persons who use governmental services pay for them, with the fee or user charge being similar to the price of a good or service in the private sector. State university tuition fees and charges for the use of parks are two good examples. The use by Texas of such financing methods is fairly similar to that of states in general, with fees constituting only about eight percent less of personal income for residents of the Lone Star State compared with all Americans.

Miscellaneous General Revenues

The most important category here is interest income on governmental cash balances and investments. Lottery proceeds, special assessments, and property sales are other examples of revenue sources. Texas receives more revenue, relative to state personal income, than the average U.S. state.

Other Own Source Revenues

There are three major categories of revenue under this classification nationally, although one does not exist in Texas, namely liquor store revenues (some states have state-owned liquor stores). The biggest category is revenue associated with unemployment compensation and public employee retirement plans (for example, employee contributions). Of secondary importance are utility revenues, primarily from public water and electric power providers. Texas receives sharply less revenue in this category than the average for the nation. This reflects not fewer public-owned utilities in Texas but rather far lower levels of provision for public employee retirement. It is an interesting question whether the Lone Star State’s lower employee retirement revenues reflect generally less generous public pension plans (perhaps because of greater reliance of employees on Social Security) than some states, or rather the existence of unusually high levels of unfunded liabilities that will haunt Texas in the future.

Federal Grants

All states receive some revenues from the federal government. Texas receives a lower amount of such revenues relative to income levels than the national average, but not dramatically lower levels.

Texas Taxes

Many claims are made on behalf of Texas' tax burden—some say it's the second lowest in the country, or in the bottom five, or bottom ten. The confusion exists because it's possible to use different figures and methods of calculation to reach a conclusion. Also, because the relative importance of local governments in providing public services varies considerably, you have to incorporate both state and local governmental spending into any meaningful comparison. It is possible to calculate the tax burden on a per capita basis or relative to personal income, with the latter measure somewhat preferable if one is trying to measure the "burden" of government on taxpayers.

In Table 2, we calculated (to the nearest dollar) the tax burden per \$1000 in personal income for Texas and its neighbors in fiscal year 1999, and listed each state's rankings with the highest tax burden state ranked first. Note that Texas' tax burden ranked 47th, making it a relatively low taxed state. Interestingly, all of Texas' neighbors except New Mexico were also fairly low tax states as well, below the median for the nation as a whole. Some six other states had tax burdens very similar (within six percent) to that of Texas: Colorado, Florida, Missouri, Nevada, Oregon, and Virginia. Several of these states compete directly with Texas, particularly for high technology business.

Table 2

Texas and Its Neighbors, Ranked in Terms of Tax Burden Per \$1000 Income, FY 1999		
State	Ranking Among U.S. States	Tax Burden \$1000 Income
TEXAS	47	\$ 96.79
Arkansas	39	104.56
Louisiana	26	108.01
Oklahoma	35	104.77
New Mexico	7	121.73

Source: U.S. Bureau of the Census, Author's Calculations

Additionally, three other states (Alabama, New Hampshire, and Tennessee) had significantly lower overall tax burdens than Texas. Thus Texas is one of a group of 10 states with a combined 65 million in population with a low or very low tax burden. That's hardly the unusual aberration sometimes portrayed by some advocates of increased taxation.

Where Does it Come From....

So we know that Texas has a relatively low overall tax burden, but not one that is so unusually low to make it unique. Indeed, low taxes are relatively commonplace among fast growing states—which of course is one factor that propels their growth. Yet looking at aggregate data disguises the details of the Texas fiscal system. Is Texas somewhat unusual? The answer, broadly, is “yes,” although that difference has actually been an enormous advantage, helping to propel the Texas economy to high rates of growth.

Table 3 looks at specific taxes, comparing Texas with the average for the United States as a whole. The reader should be cautioned that the tax categories are determined by the U.S. Bureau of the Census, and their categorization of specific taxes may differ from what others might consider appropriate. For example, the table leaves the impression that Texas does not tax corporations, which is not the case—the state has a corporate franchise tax. The Census Bureau does not consider this an income tax, but includes it in the category of “other taxes” (which is mainly why that category is so much higher for Texas than other states).

Table 3

**Tax Burden of Specific Taxes, FY 1998: Texas vs. the National Average
Tax Amount per \$1000 of Personal Income**

Tax	Texas	U.S.	% Difference Texas Vs. the U.S.
Property	\$36.97	\$32.46	+13.9%
Individual income	.00	25.64	-100.0
Corporate Income	.00	4.59	-100.0
General Sales	31.65	27.17	+16.5
Selective Sales	16.99	12.24	+38.8
Motor Fuel	5.10	4.08	+24.9
Alcoholic Beverage	0.95	0.57	+66.8
Tobacco Products	1.23	1.13	+ 8.8
Public Utilities	2.31	2.32	- 0.4
Other Selective Taxes	7.97	4.14	+92.4
Motor Vehicle License	2.24	2.08	+7.5
Other Taxes	8.39	6.24	+31.1

Source: U.S. Bureau of the Census, Author's Calculations

Property Taxes

The property tax burden in Texas is clearly above the national average as defined here. It is possible that tax rates (that is, taxes as a percent of property values) may be no higher, or much higher in Texas. Property values are often enhanced with high economic growth, and while tax rates may not be high

relative to the national average, tax bills are because of high property values. We don't have enough information to say definitively, though.

Income Taxes on Individuals and Corporations

In the typical state that levies income taxes, they raise about as much money as the property and general sales tax—upwards of one-third of all tax revenues. In Texas, the proportion is zero, subject to the caveat mentioned above with respect to corporate taxes. The implication of that, of course, is that other tax sources must carry a larger proportion of the tax burden. It turns out, though, that this is actually is a virtue, given the negative effects of income taxes on economic growth

General and Selective Sales Taxes

In general, Texas relies rather heavily on sales taxation compared with the average state. A cursory observation of combined state and local rates in large Texas cities suggests that rates on the general sales tax are at the upper end of the range found in American cities. For example, the tax rate in Dallas is 8.25 percent, equaled or exceeded in some non-Texas large cities, but many also have significantly lower rates. Also, the base subject to the general sales tax varies enormously by state, and the picture is complicated by varying local governmental sales tax rates within states. Still, Texas is a fairly high sales taxation state. As it turns out, though, the sales tax is the least harmful of the major taxes, so this feature of the Texas system is again a virtue.

Other Taxes

Note that in Table 3, Texas has relatively high taxes in the “other selective sales taxes” and “other taxes” categories (with motor license fees approximating the national average). Aside from the corporate franchise tax referenced above, another likely factor is Texas' high mineral production tax revenues, compared to other states.

...And Where Does it Go...

It is not at all surprising, given Texas' low tax burden, that the state spends less on government than the national average as well. Table 4 provides details. “General expenditure” excludes from total spending such things as spending on utilities, state liquor stores, and insurance trust plans. While overall spending is 8-10 percent below the national average when measured as a proportion of income, the deviation of spending from the national average varies substantially category to category.

Education

Critics have charged that the state of Texas has shortchanged education to pay for tax cuts that keep the state's tax burden one of the lowest in the country. But the data show how nonsensical that criticism is: At both the elementary and collegiate levels, Texans devote a larger percent of their income to education than the national average—between 6 and 9 percent higher, in fact. True, some of this spending is explained by the fact that Texas spends a good deal more than the typical state on capital outlays in education (especially school construction), which is no doubt a function of higher population growth. But the Lone Star State also spends more on current outlays as well. Indeed, more than 40 cents of each dollar of general government spending in Texas goes for education, while the comparable figure nationally is less than 35 cents.

Table 4

State and Local Expenditures Per \$1000 Income, FY 1999, Texas vs. U.S.			
Category	Texas	U.S.	%Difference, Texas vs. U.S.
Direct Expenditures	\$197.25	\$219.69	-10.2%
Direct General Exp.	171.78	189.38	- 9.3
Capital Outlays	22.90	23.92	-4.3
Operations	148.65	165.46	-10.2
Education	69.45	65.45	+6.1
Capital Outlays	9.59	7.37	+30.1
Higher Education	17.65	16.62	+ 6.2
Primary, Second. Ed.	49.95	46.03	+ 9.0
Public Welfare	22.27	29.14	-23.6
Hospitals	11.86	9.72	+22.0
Health	4.26	6.27	-32.1
Highways	11.56	12.60	- 8.2
Capital Outlays	6.83	7.03	-7.5
Public Safety	16.53	17.44	-5.2
Police Protection	6.09	7.23	-17.5
Fire Protection	2.38	2.88	-17.4
Corrections	7.34	6.18	+18.8
Other	0.72	1.15	- 37.4
Parks and Recreation	2.15	3.17	-32.0
Housing, Comm. Devpt.	2.44	3.42	-28.7
Sewerage	3.16	3.65	-13.3
Govt. Administration	7.49	10.38	-27.8
Interest on General Debt	7.99	9.11	-12.3

Source: U.S. Bureau of the Census, Author's Calculation

Welfare, Hospitals and Health

In contrast to education, Texas spends significantly less of its tax revenues on welfare—about 24 percent less. Adding together health and hospitals into the category of medical-related expenses, spending in Texas is close to the national average, being higher in hospitals but lower in the general health category.

Highways and Public Safety

Texas spends a modestly smaller proportion of its resources on highways and on public safety than the national average, with the deviation from the average most pronounced for police and fire protection (17 percent below the average) and in corrections (19 percent above the average). Some would argue that high corrections expenditures may in part explain low police/fire expenditures, since Texas incarcerates a relatively larger proportion of its criminals—and for longer sentences—than other states.

Other Forms of Spending

In other areas of spending—including parks and recreation, housing and community development, sewers, governmental administration, and interest on debt—Texas tends to spend less than the typical state. In some categories, the presence of a significant rural and small town Texas population may be partially responsible for the trend. For example, I would speculate that Texas may have a larger proportion of homes with septic tanks (and thus not using sewers) than the typical state.

Local Government's Share

State governments aren't the whole picture when it comes to funding and providing government services. Instead they share those responsibilities with a variety of county, municipal, educational, and other governmental units. In some states, more of the activity is centralized at the state level than in others. What is the situation in Texas? Table 5 shows the proportion of various revenue and expenditure categories carried out by local governments or any governmental unit other than the state government.

Table 5

The Proportion of Revenues or Spending Derived From Local Governments: Fiscal Year 1999		
Category	Texas	U.S.
General Revenue from Own Sources (non-Fed.)	50.1%	43.9%
Taxes	47.8	38.7
Property	100.0	95.1
General Sales	16.1	18.1
Motor Vehicle License	21.3	8.2
Current Fees and Charges	65.4	62.4
Direct General Expenditures	60.4	58.2
Education	77.7	72.6
Higher	23.5	16.4
Primary and Secondary	99.7	99.1
Public Welfare	2.1	15.3
Highways and Roads	32.9	39.5
Public Safety and Corrections	62.7	65.8
Governmental Administration	65.9	57.7

Source: U.S. Bureau of the Census, Author's Calculations; data are for FY 1998.

Unquestionably, Texas is more dependent on revenues raised by local governments than most states. While the average state derives less than 39 percent of its tax revenue from local governments, in Texas the proportion is nearly 48 percent. In part this may reflect the composition of taxation—Texas does not have individual and corporate income taxes, which are typically administered largely if not entirely at the state level.

With regards to spending, the pattern is less clear. There are several categories where a larger proportion of the spending actually came from the state government, although on balance again there was a slightly higher proportion of total spending financed locally in Texas compared to the nation as a whole.

Grading the Texas System

With all this in mind, how does Texas' tax system rate in terms of encouraging economic growth? I looked at three outside assessments of each state's business or fiscal climate, and did one of my own. The Small Business Survival Committee's (SBSC) "Survival Index" (Keating 2001) ranks states on a large variety of criteria; many, but not all, are tax-related (one difference: right to work laws are viewed positively by SBSC, a sentiment I would endorse based on my own research). The SBSC is interested in the climate for small business, and its criteria reflect that concern. In the table below, I have converted the SBSC numeric rankings into letter grades making "C" the average grade of all the states.

Grades from the American Legislative Exchange Council, or ALEC (Lathrop 2001), are based on both the level of state and local taxation and the changes in tax burden in recent years. Finally, I looked at Bloomberg Personal Finance’s recent evaluations (Saler 2001) of states on their “wealth friendliness”—that is, on the environment within the state for acquiring and maintaining personal wealth.

Then, I constructed my own fiscal index in order to determine letter grades for the states. I put the largest weight, some 60 percent, on the level of state and local tax burden per \$1000 in personal income in fiscal year 1998, the last year for which truly comprehensive data are available for all states. I weighted the change in that tax burden from 1990 to 1998 an additional 20 percent, and gave a 20 percent weight to the percentage of personal income taken by individual income taxes, the most invidious of major taxes from an economic standpoint. Again, I distributed the grades so the average for all states was a “C.”

Table 7

Grading the States: Texas, Neighbors, Top Sun Belt Competitors					
State	ALEC	Bloomberg	SBSC	Vedder	Median*
Texas	B	B	B+	A	B+
Arkansas	C	C	C+	C	C
California	C-	C-	D-	C-	C-
Florida	A	A	A-	A-	A
Louisiana	C	A-	C+	B	B-
New Mexico	F	C+	D-	C	D+
Oklahoma	C-	C	C	C+	C

*Where median is between two grades, higher grade is given.

Source: Lathrop (2001), Saler (2001), Keating (2001), Vedder (2001); See text.

In the end, the Lone Star State did very well in all four measures (see Table 7), and the median of all studies is a very respectable B+. Moreover, Texas generally receives higher marks than all of its neighbors, dramatically so in the case of New Mexico. While the state is graded substantially higher than one of its important Sun Belt competitors (California), it ranks below Florida, one of the best states in the Union on almost all fiscal evaluations.

What can we conclude from our ranking? Take it easy and go slow—the Texas system is not in need of radical reform. What Texas needs instead are moderate changes designed to make the Lone Star State even more attractive to individuals and businesses.

References

Keating, Raymond J. 2001. *Small Business Survival Index 2001*. Washington, D.C.: Small Business Survival Committee, July.

Lathrop, Douglas. 2001. *Recent Trends in Taxing and Spending*. Washington, D.C.: American Legislative Exchange Council.

Saler, Thomas D. 2001. Live Free or Move. *Bloomberg Personal Finance*. May.

United States, Bureau of the Census. Various Years. *Census of Governments*.

_____. Various years. *Governmental Finances*.

_____. 2000. *Poverty in the United States: 1999*. Washington, D.C.: Government Printing Office. September.

About the Author

Richard Vedder is Distinguished Professor of Economics at Ohio University. Educated at Northwestern University and the University of Illinois, Dr. Vedder has served as an economist with the Joint Economic Committee of Congress and has taught at several other universities, most recently as John M. Olin Visiting Professor of Labor Economics and Public Policy at the Center for the Study of American Business at Washington University in St. Louis.

The author of more than 200 scholarly papers and articles and six books or monographs, Professor Vedder writes and speaks frequently on tax and other public policy issues. His commentary has appeared in such leading newspapers as the *Wall Street Journal*, *Christian Science Monitor*, *Washington Post*, *Investor's Business Daily*, *USA Today*, the *Chicago Tribune*, and the *Dallas Morning News*. He has also advised political leaders in more than 20 states and several nations on fiscal policy issues. His most recent books include: *Can Teachers Own Their Own Schools* (Oakland, CA: Independent Institute, 2000), and, with Lowell Gallaway, *Out of Work: Unemployment and Government in Twentieth-Century America* (New York: New York University Press, 1997).

About The Texas Public Policy Foundation

The Texas Public Policy Foundation is a 501 (c)(3)(h) non-profit, non-partisan research institute guided by the core principles of limited government, free enterprise, private property rights and individual responsibility. The Foundation's mission is to improve Texas government by generating academically sound research and data on state issues, and by recommending the findings to opinion leaders, policy makers, the media and general public.

The work of the Foundation is conducted by academics across Texas and the U.S. and is funded by hundreds of individuals, charitable foundations and corporations. The Foundation conducts no contract research and accepts no contributions to influence outcome of research. The public is demanding a different direction for their government and TPPF is providing the research that enables policy makers to chart that new course.

Materials published by the Texas Public Policy Foundation are for educational purposes only. The views of the authors are their own and do not necessarily reflect those of the Foundation. Nothing written herein is an attempt to aid or hinder the passage of any legislation.

Join the Texas Public Policy Foundation!

Become a member of the Texas Public Policy Foundation by making an annual contribution of \$50 or more. Members receive studies, executive summaries, newsletters, policy updates and commentaries. In addition, they are invited to special events hosted by the Texas Public Policy Foundation.

Fill out the form below or sign up online at www.tppf.org

Name: _____

Company: _____

Address: _____

City: _____ State: _____ Zip: _____

Email address: _____ Fax: _____

Home Phone: _____ Office Phone: _____

Yes! I want to help the **Texas Public Policy Foundation** uphold the principles of limited government, free and competitive markets, private property rights and individual responsibility.

Enclosed is my tax-deductible gift of:

\$2,500 \$1,000 \$500 \$100 \$50*

Please bill my: MC Visa Amex

Card Number _____ Exp. Date _____

Signature _____ (required for billing)

*Introductory (1st year) or Student

The Texas Public Policy Foundation is a non-profit, non-partisan research institute that accepts no government funds, relying on voluntary support from individuals, foundations and businesses. Contributions are tax-deductible under Section 501 (c) (3) of the Internal Revenue Code.