

IS THE GOVERNOR RIGHT? :
A STUDY ON CUTTING TEXAS PROPERTY TAXES

A Senior Thesis

By

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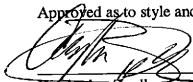
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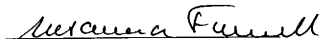
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Abstract

Is the Governor Right?: A Look at Cutting Texas Property Taxes

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In the past few years the state of Texas, under the direction of Governor George W. Bush, has seriously considered the idea of cutting property taxes. Since schools are financed mainly through property taxes in Texas, this is an extremely important and volatile issue. I chose to conduct my research on this particular topic. In my project, I looked at the history and fairness of the property tax in Texas, and alternative solutions to this state's impending school finance crisis. To accomplish these tasks, I sent out questionnaires to 500 Texas residents, researched other states, and came up with two possible solutions. This thesis will show that Governor Bush was right to pursue property tax relief, however, his methods for achieving an equitable and beneficial solution for Texas residents was flawed. Instead, the state of Texas should either implement a state income tax or use educational vouchers in place of the current property tax system.

Is the Governor Right?: A Study on Cutting Texas Property Taxes

Summary

In the past few years the state of Texas, under the direction of Governor George W. Bush, has seriously considered the idea of cutting property taxes. Since schools are financed mainly through property taxes in Texas, this is an extremely important and volatile issue. I chose to conduct my University Undergraduate Thesis at Texas A&M University on this particular topic. In my research, I looked at the history and fairness of the property tax in Texas, and alternative solutions to this state's impending school finance crisis. To accomplish these tasks, I sent out questionnaires to 500 Texas residents, researched other states, and came up with two possible solutions. This thesis will show that Governor Bush was right to pursue property tax relief, however, his methods for achieving an equitable and beneficial solution for Texas residents was flawed. Instead, the state of Texas should either implement a state income tax or use educational vouchers in place of the current property tax system.

Introduction

On April 30, 1995, Texas Governor George Bush created the Citizen's Committee on Property Tax Relief through Executive Order GWB 96-4. The Committee was charged with taking public testimony to evaluate the impact of property taxes on Texans and Texas businesses [1]. The work of the Citizen's Committee was one of a continuing series of steps taken by Governor Bush to evaluate the effect of property taxes on Texas and to explore possible alternatives [2].

In the Fall of 1995 Governor Bush also established the Staff Work Group on Property Tax Relief. The work group consisted of representatives from Governor Bush's Office, Lt. Governor Bullock's Office, House Speaker Laney's Office, and Comptroller John Sharp's Office. They identified three alternatives to the current system of school property taxes:

- * A Business Activity Tax--a broad based Texas business tax applying to "mark-up" with a deduction for capital investment,
- * A Gross Receipts Tax--a broad based business tax applying to gross receipts from business in Texas, and
- * A Sales Tax--a broadening of the sales tax base and/or possible adjustments in the sales tax rate [3].

The Citizen's Committee for Property Tax Relief was given these stipulations, however, they were not charged with proposing a specific remedy of how to solve this particular problem. They took public testimony from Texans across the state to hear their opinions and possible solutions. The Committee held 14 public hearings across the state, with over 3,200 people attending and nearly 750 registering to testify [2].

They concluded that Texas' high level of school property taxes hampers capital investment and impedes the ability of Texans to buy and keep their homes. Further, property taxes may not be well-suited for providing long-term adequate revenues for our public schools. Finally, the Committee also found that substantial public sentiment exists for property tax relief [2].

The Governor took these findings and came up with his own plan for property tax relief. His proposal called for:

- * An increase in the homestead tax exemption by \$20,000 on that portion of local property taxes for school maintenance and

operations.

- * Roll back local school property taxes by 20 cents.
- * Set aside \$1 billion of the state's cash surplus for property tax relief .
- * Boost sales and motor vehicle sales tax by a half-cent on the dollar to 6.75 cents.
- * Eliminate the corporate franchise tax, which taxes a mix of capital and profits and replace it with a 1.25 percent tax on business sales over \$500,000, minus the cost of goods and capital invested [4].

These recommendations were met with both praise and criticism [5]. Organizations like the Association of Professional Educators were very interested because it has been estimated that each \$1 billion shift from local property taxes to state funding could produce up to an 18 percent increase in each salary step for teachers [6]. Industries with large amounts of taxable property, such as the refineries, applauded the governor's proposal [7]. Some critics, however, said Bush's proposal would have created a greater burden on low-income Texans who would have to pay more sales tax [8]. Many in the business community were upset because it would tax many lawyers, architects, and other professionals who, organized as partnerships, do not pay the franchise tax [9]. Dick Lavine, a tax analyst for the Center for Public Policy Priorities, said that "consumers will feel the brunt of the new business tax because it will be passed through in higher costs for goods and services" [10].

Governor Bush's plan was then passed on to the Texas Legislature. A special House subcommittee debated the governor's proposal before coming up with their own solution. Eventually, the House approved a plan that would have cut the average homeowner's school property taxes

in half and boosted taxes largely on businesses to pay for it. Specifically, the plan called for:

- * Residential school property taxes for maintenance and operation would be capped at 70 cents for \$100 valuation. The current limit is \$1.50.
- * Business school property taxes would be capped at \$1.05 per \$100 in valuation, down from \$1.50.
- * The state would help school districts pay for school buildings and debt.
- * Local governments that add their sales taxes to newly taxable goods and services would be required to use the money to lower property taxes by an amount equal to the new revenue or to ask voters for permission to spend the additional money on special projects [11].

The plan would have added about 30 goods and services to the list of those subject to the state sales tax and would expand the business franchise tax to business partnerships, such as law firms and medical partnerships. Currently, the franchise tax is applied only to corporations.

Next, the Senate took up the issue of property tax reform. However, it did not take long for them to reject the House's plan to create a statewide business property tax to help pay for public schools, saying it was the "mother of all Robin Hoods" [12]. The House plan, for which Bush lobbied, would have increased the state's share of public education funding from the present 46 percent to about 80 percent. Along with raising other state taxes, business property would have been taxed for school operations. This would have allowed school children to share in the most lucrative property tax revenue. Sponsors of this plan said that it would repeal Robin Hood, but in reality it would wipe out only one specific Robin Hood law--the 1993 school finance bill--and

replace it with an even more far-reaching share-the-wealth plan [12]. The 1993 school finance law forced the state's wealthiest districts to share local tax revenue with poor districts.

After more debate, the Senate came up with their own "scaled-down" version of tax relief. The Senate proposal would trade \$1.4 billion in higher state taxes over the next two years for lower school property taxes. This would have reduced property taxes on both residential and business property by an average of 17 cents per \$100 valuation [13].

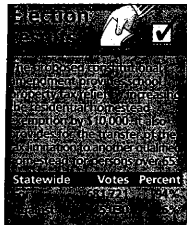
Like the House plan, this was also met with criticism, the largest of which coming from professionals organized as partnerships. Many lawyers and doctors opposed it because the Senate proposal would join the House in putting partnerships under the franchise tax. Despite these objections, many were still hopeful that a compromise could be reached in the Texas Legislature. However, with less than four weeks remaining in the session, it would prove to be a difficult task.

The House and the Senate tried quickly to resolve the differences in the two plans. However, the fatal sticking point between the House and Senate would prove to be the larger state tax increases the House plan would have required. With only days left, both plans were declared dead. Despite their failure to reach a compromise, Governor Bush suggested that the \$1 billion in state budgetary savings be used to provide a small amount of property tax relief [13].

Although Bush lost the "substantial" property tax relief bill he wanted, the more modest plan would meet little resistance from the Legislature. State lawmakers approved a proposed constitutional amendment to increase the homestead property exemption from a state minimum of \$5,000 a year to \$15,000 a year [14]. In short, the average

homeowner would save approximately \$140 a year. This plan would use \$1 billion left over from the state budget to pay for the increased property tax exemptions. However, voters would still have to approve the constitutional amendment on August 9, 1997.

Governor Bush began canvassing the state early to secure victory. Since turnout has been historically low in these types of elections, Bush wanted to take no chances. Of course, this election would prove to be no exception. Despite less than a 6.82% turnout, the constitutional amendment was passed overwhelmingly [15].



Texas homeowners now will have to pay slightly less than they did before. However, does this really solve the property tax/school finance crisis? What about renters? Will they receive the benefits of this reduction? There are a number of options which have been discussed, however, it is almost inevitable that Texas will have to seriously consider implementing a state income tax. To understand this reasoning, it is important to first analyze the recent history of property taxes in the Lone Star State.

Recent History

Property Taxes in Texas

In 1982, the state of Texas began a new way to determine property taxes by consolidating the appraisal function into a single office in every county. "Initially, this reform caused a wave of state-wide reappraisals. Assessed values that had been unchanged for years suddenly shot

upward, prompting citizen outcries and leading to various exemptions designed to lessen the impact of reform. In addition to the initial revaluation, Texas committed to an on-going effort to keep assessed values at current market levels" [16].

During the mid-1980's, school finance reform became an important topic of discussion. Property taxes began to increase to comply with the recent court-ordered funding changes. With these increases also came a reduction in property values due to the real estate slump. This declining tax base was left to fund growing revenue requirements in Texas.

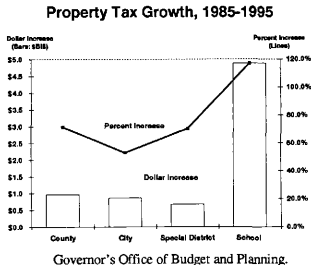
Generating an estimated \$15.4 billion of revenue in 1995, property taxes are the chief source of revenue for Texas local governments. Taxes apply to all real property and any tangible personal property held for the production of income. Almost 60% of property taxes are levied by school districts; the remainder by cities, counties and a variety of special districts, such as community college districts, water districts, and hospital districts [2].

Research

Problems with the Property Tax

In order to make changes to the current system, problems must be identified with the property tax. The following paragraphs discuss just a few of the reasons why changes must be made to this system.

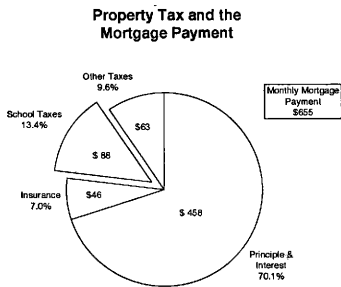
Increasing by a total of nearly \$8 billion, property taxes have



doubled since 1985. While counties, cities, and special districts all have raised taxes substantially, local school districts have imposed the greatest share of the increases. Over the past ten years school taxes have also more than doubled, adding nearly \$5 million to the overall tax load Texans pay [3].

During the last decade there have been few jobs created in capital intensive industries. Almost all of the job growth in Texas in recent years have been in lower-paying labor intensive industries. This can be partly attributed to Texas' high property tax rates. The average property tax paid per employee by capital intensive industries is almost ten times greater than that paid by labor intensive industries [3]. Texas is one of only 11 states that taxes inventories and this is particularly burdensome because it inflates a business' cost to operate here. Basically, property taxes are a direct tax on capital investment, and serves as a substantial barrier to businesses wanting to expand or locate in Texas.

The property tax can inflate the cost of home ownership by nearly one-third. For example, to buy and mortgage an \$80,000 home with 20 percent down, at today's interest rates would require an average monthly



payment of \$655.

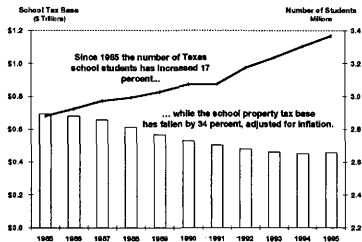
Almost one-fourth of this mortgage would be for property taxes, and school taxes alone would cost \$88 per month. The barrier these taxes present is evidenced by statistics.

Texas is ranked 43rd among all states in home ownership. The U.S. Bureau of the Census confirms that our rate of home ownership is on the decline while our local property taxes have increased. Obviously, property taxes can impose a substantial barrier to individuals trying to buy a home [3].

Another reason Texas' property taxes are unfair is the fact that it is an involuntary tax. Sales taxes have a voluntary aspect to them because the consumer exercises discretion over what is bought. Some necessary items such as clothes are taxable, but the consumer can determine the amount of tax they pay by choosing items of greater or lesser cost. Even federal income taxes have an aspect of taxpayer control. By investing in tax exempt securities or claiming the child care credit, taxpayers can affect the amount of tax they owe through careful tax planning. However, property taxes are the least controllable. After a home is purchased, there is little control over its tax treatment. Its taxable value is set by a local appraisal district based on local market conditions over which the homeowner has no control. Tax rates are set by cities, counties, and school districts and often public input has little effect [3].

Texas schools have added nearly half a million net new students over the past ten years while the tax base (adjusted for inflation) actually declined by 34%. Public education is experiencing tremendous growth while being

Diverging Trends



Sources: Texas Association of School Boards

financed with our most stagnant tax source - the property tax. School tax rates have increased dramatically to offset the loss of revenues from the declining tax base. These rate increases have been exacerbated by the fact that state aid, while up \$3.6 billion over the past ten years, has failed to keep pace with the rising costs of educating Texas school children. This has placed even greater demands on local school property taxes [2].

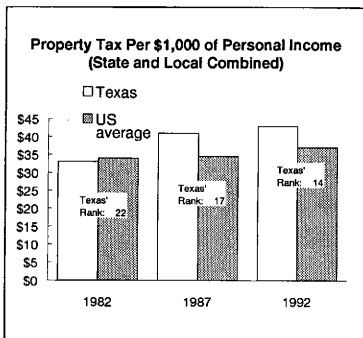
The portion of the tax base made up by single-family residences also demonstrates the inadequacies of the property tax system. Since 1982, it has risen from 28 percent to 40 percent. Although stagnant overall, significant shifts in the value of different classes of property have occurred, resulting in a rise in the homeowner's share and a decline in the oil and gas industry's share. As a consequence, school districts are becoming increasingly reliant upon homeowners to fund public education [3].

One of the largest concerns about the role of the property tax in public school finance stems from the fact that many districts are nearing their allowable tax rate ceiling. Generally, state law limits taxes levied for maintenance and operations purposes to no greater than \$1.50. As more and more districts near this tax limit, another round of legal challenges against the school finance system will probably ensue.

The cost of educating Texas school children has increased substantially over the past ten years, but state funding has not kept pace. The 74th State Legislature provided a sharp increase in new state aid, but the state share is still well under half. This has resulted in local school districts relying more and more on the school property tax [3].

Finally, Texas' ranking in property taxes as a percent of personal

Income has skyrocketed in the last 15 years. Between 1982 and 1992, Texas jumped from 22nd to 14th out of all 50 states and the District of Columbia. We also experienced the third highest growth in the country during that same span



(31.2 percent over economic activity). The rate of local tax increases, primarily the property tax, was 33.8 percent greater than economic activity, ranking local tax acceleration in Texas the highest in the country [3].

How is your property tax determined?

Most homeowner's are not exactly sure how their property taxes are determined. The Texas State Constitution Article 8 section 20 states, "No property of any kind in this State shall ever be assessed for ad valorem taxes at a greater value than its fair cash market value nor shall any Board of Equalization of any governmental or political subdivision or taxing district within this State fix the value of any property for tax purposes at more than its fair cash market value." However, some have argued that appraisal districts appraise the typical home far in excess of its fair cash market value [17].

The appraisal district adjusts the value of your home based on

comparisons to real estate home sales in your neighborhood. Nealy all real estate sales include costs not incurred in a cash transaction. The sale price includes expenses paid by the seller such as real estate commissions, inspection fees, title insurance, and attorney fees. This inflates the value of the home far in excess of its fair market value. [17].

How much property taxes are you paying?

Most homeowners make their mortgage payment each month, paying little attention to the "details" of the payment, such as the amount that goes into escrow for the insurance and property taxes. Perhaps the best way to view how much you are paying in property taxes to fund your local schools is to look at a couple of examples.

If you purchased a home in 1984 for \$50,000 (the statewide average school tax rate at that time was 60 cents per \$100 valuation), you paid \$300 a year, or \$25 a month, in school property taxes. Today, that \$50,000 house, based on the state average school property tax rate of \$1.39 per \$100 valuation, draws \$695 a year, or \$58 a month [18]. Maybe you have a more expensive home. If in 1985 your house was on the tax roll at \$100,000, you were paying \$600 a year in school property taxes, or \$50 a month. That same house, based on the 1994 state average tax rate of \$1.39, and not including appreciation, would amount to \$1,390, which results in a monthly school tax bill of \$155 [18].

Homeowners are not the only individuals upset over the current property tax. For agricultural producers, "agricultural land qualifies for open space valuation based on its productive value to determine its taxable value." This is not an exemption. It is just an alternative method of valuation [18].

In 1994 the tax benefit of open space valuation to farmers and ranchers was \$643 million. Still, they paid \$470 million in school property taxes. It has been estimated that by the year 1999, they are expected to pay \$600 million. Even with a reduction in taxable value, agriculture paid approximately 9 percent of the total business paid tax. "But as an industry, agriculture accounts for less than 3 percent of the gross state product" [18]. Theoretically, agriculture is paying more than its share in the business community of this state.

Survey of Texas Residents

While the issue of property tax reform has been discussed in the governmental arena for a little over a decade, a surprisingly low amount of research has been conducted concerning the public's interest in this particular topic. Due to this fact, I first decided to obtain my own research from individuals across the state.

Obtaining information from the diverse population that makes up the state of Texas would prove to be a difficult task. In order to complete this goal, I chose to seek help from Southwestern Bell Headquarters in San Antonio. They offered to generate 500 names by zip code from the nine most populous areas within the state. To simplify the results of the survey I chose to divide these geographical areas into the following cities: Amarillo, Austin, Dallas, El Paso, Fort Worth, Houston, Lubbock, McAllen, and San Antonio. Of course, not all of those surveyed were from large metropolitan areas. However, the results have been tabulated by "city" for simplicity. This practice can best be illustrated by the following example. Since the Houston area is the state's largest city, more names and addresses were generated by zip code from this area

than any other. Of course, the smallest number of names were generated by zip code from the Lubbock area since it is less populated.

Every individual that was sent the survey received a letter that explained briefly the purpose of the survey and some history related to the questions. The letter which accompanied the questions can be viewed in Appendix A. My survey consisted of six YES/NO questions, one short answer, and a space for additional comments and concerns. The purpose of this questionnaire was to determine the importance of property tax relief to the average Texan, and whether they were aware of the current legislation concerning this issue. To view the entire survey, please refer to Appendix B.

Out of 500 surveys distributed through mail, 66 individuals responded to my questions. When asked if they were familiar with Governor Bush's original property tax relief plan, 68% responded "yes" and 32% said "no." Of those that responded affirmatively to the first question, 77% of them were in favor of that plan. Obviously, there may have been some individuals that were unfamiliar with the property tax issue altogether, however, this does give some indication that there are many Texans concerned with this particular issue.

The next question dealt with the August 9th vote on the constitutional amendment. 72% of those responding to the survey said they would vote on the proposal to increase the homestead exemption. Of those, 55% said they would vote "for," 15% "against," and 30% were "not sure."

The third question asked, "If you are planning to vote against the plan, how would you like the state to use the money that would otherwise be used for the tax relief?" Not everyone responded to this

short answer question, however, I did receive 17 suggestions. The largest of these was to use the money to help improve education. Other responses included using the money to help improve the environment, keeping it for another try at property tax relief, and using the money to help the state market itself better to attract other businesses.

While surveys were sent to individuals who rented their apartment or house, most respondents to the survey were individuals who owned their dwelling. 94% of the respondents said they "owned" their house or apartment. This overwhelming percentage could be attributed to the fact that most of renters believed that the property tax/homestead exemption did not effect them.

The last question on the survey was used to get a sense of what some Texans felt about our state government. The majority, 64%, feel that the elected officials in the Texas Legislature do not effectively represent their interests. 26% respondents believed they were doing a good job, and 10% were still undecided.

At the end of the survey I provided a space for the respondents to include their own additional comments or concerns. This actually was the most beneficial aspect of my survey. It provided me with additional insight into this problem that I might not have seen before. In fact, it helped lead me to some of my conclusions which I will discuss later. While obviously not scientific, the next few paragraphs include some of the responses I gathered from various people around the state.

One concern many individuals had was the fact that they viewed this property tax issue not as a tax relief, but more as a shift of the tax burden. One individual from Austin wrote, "I do not consider lowering one tax and raising another as tax relief...especially if the new taxes are

not deductible on our federal income tax." Also, some individuals stated that they were concerned about getting a property tax break, but paying for it through higher sales taxes.

Some citizens said that a property tax break would be the only way to keep their house. An elderly couple in San Antonio stated, "The property tax relief plan will help people like my wife and I who are senior citizens on a fixed income to hold onto our home. We need such a tax break." Along with this support, there were a number of individuals pleased with what the governor was trying to accomplish. For example, an individual from Dallas remarked: "I believe that Governor Bush represents the people of Texas best interests. I am sorry his property tax relief plan was not approved."

While some said that any type of tax relief was welcome, many felt that "the watered down plan only touches the tax relief for homeowners—more should be done." They are concerned that the state legislature may in fact not be acting in the best interests of their constituents. One individual in the Dallas area voiced her opinion by comparing Texas politics to the stock market. "You gamble that the area that will suffer increased taxes is not one area that significantly affects the particular individual who is voting."

Others that responded to the survey had some interesting suggestions. For example, one lady whose son attends private school suggested that parents who choose an alternative means of education (i.e. private schools) should receive some form of tax break. She argues that, "you can live in an apartment, have 10 children, send them to public school and never pay a penny! But, own a house, choose private schools and pay both school taxes and private school tuition." This concerned

individual did state that a portion of her taxes should go towards educating the children in her community, however, she believed that "parents of children in private schools should get a tax break-even if it's only \$150!"

One suggestion that I was a little surprised to see was the possibility of a state income tax. For years Texans have fought to keep the dreaded "I" word out of the legislature, however, some respondents to my survey suggested that invoking a state income tax would be the only fair way to alleviate the property tax dilemma and fund our state schools. One concerned individual in the Fort Worth area said that "I would rather have an income tax than these constant higher and higher property taxes. Such high property taxes are terribly hard on retirees." Others responded by saying that instead of raising additional revenue by the sales tax, "Texas needs an income tax!" While support for this idea was not overwhelming, I decided to investigate this concept a little more. After months of researching this concept, I believe that a state income tax may be one of a couple solutions to this question.

The "I" Word

"Anytime you have a major tax missing from the three-legged stool, you have a problem," stated Scott Mackey of the National Council of State Legislatures. "By three-legged stool, he is referring to the three major taxing sources that most states rely on for revenue - sales, property, and income" [19]. Texas is one of only seven states without a personal income tax and according to many analysts, that will make it difficult for legislators to ever provide significant relief on local property taxes.

Although states that have no income tax are often viewed as staunch anti-tax proponents, studies show they compensate for that revenue with other charges and fees. Many Texans still believe that Texas' taxes are lower than the rest of the country's, largely because there is no state income tax. "Newcomers have been lured by the low-tax-rate myths that are as much a part of Texas as Pecos Bill" [20]. Part of this problem lies in part to the way average tax burdens are calculated.

One of the problems with figuring out the tax burden of the average Texan compared to residents of other states is that much depends upon who is doing the figuring, and why they're doing it. Different organizations or publications use different methodologies and formulae [21]. For example, State Budget and Tax News, ranked Texas 19th in terms of taxes per capita, based on raw U.S. Census Bureau data. The average Texan paid \$1,757 in taxes in 1991, the publication showed. However, these figures can be deceiving. "If you look at the numbers compared to state taxes, Texas is in fairly good shape," said Bob Norwood, Director of Research for the Texas Research League in Austin. "It's the local taxes that drive up the numbers. When you throw in the state-local tax burden, we jump up to the top" [21].

Texas taxes were low only 15 years ago, but they have crept up since the 1980's to move Texas from having one of the lowest tax rates in the nation to the middle as far as the proportion of income paid in taxes, according to the Tax Foundation, a Washington think tank, and U.S. Census figures. Total taxes were higher in 1996 on average than for taxpayers in states such as Missouri and Indiana, where state income taxes are levied [20].

One point that most will agree on is the fact that more and more of the tax burden is falling on Texas residents. Taxes have increased over the years partly because the population has exploded. "Taxes have risen with the influx of newcomers, increasing the need for sophisticated highway systems, more and better schools, first-class airports and other services," said Dr. Bernard Weinstein of the Center for Economic Development and Research at the University of North Texas. This growth requires more spending for schools, roads, police, and other services. The federal government has shoved many services it once paid for onto states. Additionally, Texas has seen the decline in a traditionally major source of revenue - oil [20].

Since the average Texan's taxes have risen in recent times, many are in favor of higher business taxes. However, higher business taxes would only be passed on to consumers in higher prices, so the individual loses again, economists said [20]. Also, raising the taxes on the business sector may not provide enough money to finance the schools and other districts which are funded currently by the property tax. According to the National Council of State Legislatures, using a business activity tax, gross receipts tax, and/or a value-added tax would not generate enough revenue to replace one of the "big three" (sales, property, income). As an example, Michigan has adopted a business value-added tax, but it has not proven to be a major revenue producer [20].

Regressive v. Progressive

According to the non-partisan Citizens for Tax Justice (CTJ), Texas ranks among its "Terrible Ten" in terms of tax fairness. The reasoning behind this distinction is the fact that poor residents bear a higher tax

burden than the wealthy. "The taxes may be 'low,' but the richest Texans...aren't paying anywhere near their fair share," said Doug Kelly, CTJ's Director of Tax Analysis. "Texas has one of the most unfair tax systems in the nation" [21]. When tax experts refer to "fair" and "unfair" taxes, they are actually discussing the differences between "progressive" and "regressive" taxes. To simplify discussion, a tax is regressive if it makes no differentiation between the income of the taxpayer.

All of the taxes from which the state and localities derive revenue in Texas are regressive. (1) Examples of these regressive taxes include sales, excise, and property taxes. For example, each time a poor individual buys gas, that person pays the same tax as multi-millionaire would buying the same product. On the other hand, progressive taxes are graduated. In short, the more you make, the more you pay. For instance, income taxes are viewed as being progressive. According to Mr. Kelly of the CTJ, "the only tax that is going to ask...(the wealthy) to pay their fair share is an income tax" [21].

During the 1980's, many of the problems with fairness in the tax system arose when the rich got wealthier and the rest were doing all they could to keep up with inflation. A study by the Federal Reserve Board recently confirmed this fact saying that "the income of affluent Americans rose much faster than the incomes of other Americans during the Reagan years" [21]. To put in a Texas perspective, take the following example. A Texas family making \$10,600 annually (placing it in the poorest fifth of the state's families) paid 17.1% of its income in taxes in 1991. A middle income Texas family earning \$35,300 saw state and local taxes eat up 8.4% of their income. However, the wealthiest 1% of Texas' residents (those earning more than \$945,000 a year) paid just 3.1% of

their incomes in state and local taxes in 1991 [21].

Citizens for Tax Justice, which describes itself as a non-profit and non-partisan coalition of labor, public interest and grassroots groups, advocates an income tax to fix Texas' property tax fairness woes. "The tax system got more unfair from 1985-1991. Every time Texas needed money to fund roads and bridges, it had to increase the sales tax, had to increase the gas tax, it had to increase the cigarette tax because those were the only taxes available. Middle and low income people didn't see their incomes increase in real terms. Meanwhile, the incomes of the top 1% shot way up. A well-structured income tax will automatically catch that income growth" [21].

One Solution

According to a May 1997 article in Texas Monthly, a personal income tax of 2 percent of one's federal taxable income would produce about \$4 billion a year. This tax would be fair, desirable, sensible, and efficient [22].

If instituted, this state income tax would grow as the state's economy and population grew, assuring the public schools adequate funding. Unlike the property tax, this would also be fair. An income tax has to be paid only if one makes money. It is a desirable tax since (unlike the sales tax) it is deductible from one's federal income tax. Also, a state income tax would be sensible because it taxes professionals without hurting the Texas economy. Along with these traits, it would be simple and efficient to collect. Essentially it would be a flat tax that would assess everyone at the same rate.

Of course, instituting such an idea would be political suicide.

However, Texas has a tax structure that dates from a century ago when wealth was in property rather than wages and investments. "For most of the twentieth century, oil and gas revenue has shielded our tax structure from reality. Now, as the oil plays out, we find ourselves in the same position that other states faced two or three generations ago, but we still coddle the attitudes we cherished while the oil was flowing" [22]. Instead of concocting some weird array of various taxes to pay for school finance, perhaps we should shift the tax burden away from property taxes and towards a more simplistic and fair solution-the state income tax.

Many individuals argue that an income tax punishes people for working hard. That in essence, instead of helping the economy, it would in actuality stunt economic growth. Why would you want to work harder and more efficiently if the government would only take it away? Maybe there is not one "cure all solution," but another idea that might also be considered is educational vouchers.

Educational Vouchers

During the eighteenth century Adam Smith, the great economist, wrote "Wealth of Nations." In this thesis, he shows how competition in the marketplace would lead businessman to supply the goods consumers want, to produce these goods efficiently, and to change only what they are worth [23]. Perhaps, we can use these same principles to come up with a solution for the current property tax predicament. Many argue that educational vouchers would increase competition amongst schools and make our entire educational system better and more efficient. To get a better understanding of this concept, we should look at an example.

In November of 1993 California voters went to the poles to vote on

Proposition 174, the Parental Choice in Education Initiative. This proposition would have established a system of annual vouchers, funded by public tax dollars, that elementary and secondary students could use to pay tuition at private schools. Essentially, the legislature would determine the value of the voucher, but it would equal at least one-half of the prior year's total state spending per public school K-12 pupil (roughly \$2,600). Although this referendum was soundly defeated, radical school finance does seem inevitable in that state [24]. Texas could benefit from some of the ideas discussed during this debate.

Many individuals argue that vouchers should be given only to low-income families since it is almost always their children who are saddled with attending inferior schools. Middle and upper-income families can move to the good school districts or send their children to private schools. While these ideas may be valid, an even better solution might be to give vouchers not only to students from poorer families but also require public schools to become partly self-supporting by charging all students tuition equal to the voucher level. "For example, public school tuition would equal \$3,000 if that is the value of school vouchers. Taxes would have to cover only the excess of public-school expenditures over tuition income" [25]. Of course, there is precedent for public schools charging tuition. During the foundation of our country's school system, common schools required fees to attend those institutions.

Income received through tuition would also help offset any reduction in government spending on public schools because of the public financing of tuition vouchers. Such income would also make it easier for public schools to finance a continuing growth in spending on students. This increase has more than doubled during the past twenty

five years [25].

Gary Becker, the 1992 Nobel laureate and Fellow of the Hoover Institution stated in a Business Week article that, "opponents argue that vouchers and scholarships will enable private schools to get the 'cream of the crop.' That the better and more ambitious students would leave public to attend private schools. As a result, public education would be stuck mainly with students who are unruly, uninterested in learning, or mentally handicapped." However, Becker also mentions that this scenario assumes that public school performance will not improve when faced with competition from private schools [26].

A voucher system may actually expand private schools, but also increase the competitive pressure on the public school system. This would hopefully promote change and the majority of public school teachers and administrators would try to reform the public school system if there was clear evidence that competing private schools were attracting better students with the vouchers. Proponents of this system also argue that those schools slow to change would lose students and be under political pressure to respond to the increased competition. School boards and voters would then be willing to cut budgets and remove those officials not willing to compete for students [26].

Another Solution?

Texas might consider giving vouchers and charging tuition as a form of school finance relief. If public schools did charge tuition, then families would determine where to send their children by comparing differences in quality between private schools and available public schools to differences in tuition. This competition would not only force

public schools to become better, but private institutions as well.

There are some drawbacks to this idea, however. Issuing vouchers could be a tremendous risk. Californians defeated their referendum because they felt that Prop 174 would actually add to the deficit in the state's budget. Depending on the number that use the vouchers, costs may either rise or fall. Obviously, this is something the state should consider before implementing such an idea.

Despite this problem, Texas does need to do something before it finds itself in a school finance crisis. Competition amongst schools would probably force public schools to become better and it could lower costs. As an example, competition between private colleges and tuition-charging public colleges has improved the performance of both. Educational vouchers may not be the only answer, but the advantages of such a system make it important enough to warrant it serious consideration.

Conclusion

Is the Governor right? The answer to that question is both "yes" and "no." Governor Bush was right to pursue property tax relief, however, his methods for achieving an equitable and beneficial solution for Texas residents was flawed. The property tax system in this state is both undesirable and unfair. We may proceed fine in the short term, but the sooner Texas deals with this problem, the easier it will be to avert this looming financial crisis. A state income tax would be a good way to ease some of the burdens placed on Texas residents, and produce a more stable school system. Also, educational vouchers might be an excellent option to pursue. Increased competition has worked in the past, and

there is really no reason to believe that such a system would not work in this context.

Obviously, this is a very difficult topic and a number of individuals would be upset with whatever path is chosen. However, a state income tax or educational vouchers are the two best options for solving the property tax dilemma. The governor and the Texas Legislature should continue in their efforts to provide proper tax relief, however, it will be up to the citizens of this state to get involved and ensure a better future for themselves and this state's children.

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Appendix A

July 14, 1997

Dear Fellow Texan:

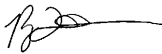
My name is Ryan Tucker, and I am a student at Texas A&M University. I am doing a research project that deals with the recent property tax bill in the state legislature. To complete my project, I am conducting a random survey. I would appreciate it if you would help me in filling out the attached survey. For your convenience, I have enclosed a self-addressed, stamped envelope.

In January 1997, Governor George Bush proposed a property tax relief plan. This plan would have cut property taxes by a large amount. However, other taxes would have been raised to make up for this lost money. The governor sent this plan to the Texas Legislature. The state legislature did not like this plan and came up with two of their own. Both of these plans were less extreme than the governor's proposal. The Texas Legislature could not come to an agreement on these two plans. Now, lawmakers have come up with a different way to cut property taxes. They have proposed a constitutional amendment that would save a taxpayer with an average home (valued at \$61,500) \$140.00 a year. People with more expensive homes do not save much more than this. A person with a house valued at \$100,000 would save \$150.00 a year on average.

On August 9, 1997, Texas voters will decide whether they want this property tax relief. If the voters turn down the constitutional amendment for property tax relief, then the money that would have otherwise been used for the tax relief would be applied to other benefits by the state in the future.

If at all possible, I would like to have this response back before August 9, 1997. Thank you for your time and consideration.

Sincerely,



Ryan Tucker

Enclosure

Appendix B

Questionnaire

Please circle your response.

1. Were you familiar with Governor Bush's original property tax relief plan? YES NO
- If "YES," were you in favor of that plan? YES NO
2. Are you planning to vote August 9th on the constitutional amendment? YES NO
- If "YES," how do you plan to vote? FOR AGAINST
3. If you are planning to vote against the plan (if "For" the plan then skip to question #4), how would you like the state to use the money that would otherwise be used for the tax relief? _____
4. Do you own or rent your house or apartment? OWN RENT
5. Do you feel your elected officials in the Texas Legislature effectively represent your interests? YES NO

Additional comments or concerns: