TEXAS BUSINESS REVIEW

Bureau of Business Research
College and Graduate School of Business, University of Texas at Austin

April 1994

# Texas Taxes: A Comparison with Other States

Despite tax increases in recent years, Texas remains below the national average for state and local taxation. The overall tax burden in Texas, relative to economic activity, is about 6 percent below the national average, and Texas ranks 32nd among the states and the District of Columbia in taxes as a percentage of income. In 1991, the latest year for which complete nationwide data are available, state and local taxes equaled about 11.06 percent of total U.S. personal income. In Texas, the corresponding percentage was 10.41. From a tax viewpoint, Texas remains a relatively favorable location for business.

## Taxes in the United States and Texas: Trends and Comparisons

Nationwide, state and local tax levels in relation to income increased sharply from the 1950s through the early 1970s, reaching an all-time high in 1973. Tax levels moderated somewhat during the late 1970s and early 1980s before peaking in 1988. Across the country, state and local tax levels have decreased slightly in relation to income since 1988.

Although Texas consistently lists below the national average, the gap is narrowing, as illustrated in table 1. In 1970, Texas ranked 48th among the 50 states and the District of Columbia in the ratio of state and local taxes to income and remained in the 40s throughout the 1970s and 1980s.

Comparisons of tax levels among states must take into account both state and local taxes. The funding arrangements for such major governmental functions as education, public safety, and transportation improvements vary from state to state. In one state a particular function may be the responsibility of the state government, while another may delegate major responsibility for that function to local governmental entities. Such relationships are not always constant over time, as indicated by the controversy over public school funding in Texas.

Across the United States, local taxes have increased more rapidly than state taxes in recent years. Local taxes topped 40 percent of the combined total of state and local taxes for the first time in 1990. In Texas, local taxes account for a larger-than-average component of total taxes, representing more than 47 percent of total state and local taxation. The rate of increase for local taxes in Texas has been comparable to the national average: local tax collections were up 6.9 percent in Texas between 1990 and 1991; in the United States, 6.7 percent. On the other hand, state taxes increased by 3.3 percent nationwide at that

**Table 1**
**State and Local Taxes, United States and Texas,**
**1970–1991, selected years**
**(percentage of total personal income)**

| Year | United States | Texas | Notes |
|---|---|---|---|
| 1970 | 10.91 | 9.09 | |
| 1973 | 11.69 | 9.42 | U.S. all-time high |
| 1975 | 11.26 | 9.35 | |
| 1980 | 10.44 | 8.71 | Recent Texas low |
| 1981 | 10.26 | 8.97 | Recent U.S. low |
| 1985 | 10.89 | 9.72 | |
| 1989 | 11.11 | 10.43 | Texas all-time high |
| 1990 | 11.10 | 10.30 | |
| 1991 | 11.06 | 10.41 | |

Sources: Developed from data in U.S. Department of Commerce, Bureau of the Census, *Government Finances*, and Bureau of Economic Analysis, Regional Economics Information System compact disc.

same time, while Texas state tax collections increased by 8.8 percent. In 1992, Texas state tax collections again increased faster than the national average, increasing by 6.3 percent against 5.5 percent nationwide.

## Tax Levels of the Major States

The fifteen states with 1990 populations of more than 5 million account for about two-thirds of the total population and for a slightly larger share of income. Texas ranks eighth among these states in terms of state and local taxes relative to income (table 2). New York has the highest tax level of the major states. Among all 51 jurisdictions, only Alaska and the District of Columbia have higher taxes relative to income. Alaska derives a large portion of its tax revenue from oil and gas severance taxes, which presumably are passed on to customers in other states. The District of Columbia (which, of course, has only "local" taxes) relies heavily on individual taxes, having relatively little industry and much tax-exempt property. Michigan, New Jersey, California, and Massachusetts are the other major states with relatively high tax levels. In both California and Massachusetts, tax rates have moderated considerably in recent years. Large population states with tax rates lower than Texas include Illinois (barely), Indiana, North Carolina, Pennsylvania, Virginia, Florida, and Missouri. Only two smaller states—Alabama and Tennessee—have lower tax rates than Missouri.

**Table 2**
**State and Local Taxes,**
**Most Populous States, 1991**
**(percentage of total personal income)**

| State | Percentage |
|---|---|
| New York | 14.95 |
| Michigan | 11.37 |
| New Jersey | 11.07 |
| California | 11.06 |
| Massachusetts | 10.85 |
| Ohio | 10.49 |
| Georgia | 10.47 |
| **Texas** | **10.41** |
| Illinois | 10.39 |
| Indiana | 10.22 |
| North Carolina | 10.13 |
| Pennsylvania | 9.96 |
| Virginia | 9.86 |
| Florida | 9.84 |
| Missouri | 8.97 |

Sources: Developed from data in U.S. Department of Commerce, Bureau of the Census, *Government Finances*, and Bureau of Economic Analysis, Regional Economics Information System compact disc.

## Types of State and Local Taxes

Available data classify state and local taxes into four major categories: income, sales, property, and other. At the state level, income taxes are the most important type of tax, representing about 38 percent of all state taxes. Individual income taxes produce most of the revenue, accounting for about 32 percent of total state taxes, while state corporate income taxes make up about 6 percent of state tax revenue. Only four states have no individual or corporate income tax. These are Texas, Nevada, Washington, and Wyoming. Three other states—Alaska, Florida, and South Dakota—have a corporate income tax but no individual income tax.

Across the nation, the general sales tax is the second most important type of tax at the state level, representing about 33 percent of total state tax revenues. The general sales tax is even more important in Texas, producing slightly more than 50 percent of all state tax revenue. Only five states have no general sales tax: Alaska, Delaware, Montana, New Hampshire, and Oregon.

Although a relatively minor source of income for state governments (about 2 percent of state tax collections), property taxes account for about 75 percent of all local tax revenues nationwide. Local governments in Texas are even more dependent on property taxes, deriving about 81 percent of their tax income from this source. Sales taxes are the next most important source of tax revenue for local governments, producing about 10 percent of local tax income nationwide and about 12 percent in Texas.

The "other" taxes are a mixed bag. They include various selective sales taxes, such as those on motor fuel, alcohol, and tobacco; taxes on various forms of gambling; license fees (which are considered taxes in federal data compilations); death and gift taxes; and severance taxes. Nationwide, taxes other than income, general sales, and property represent about 23 percent of total state and local government tax revenue. Their contribution to state coffers nationwide is larger at about 27 percent. With neither an income tax nor a state property tax, Texas relies on "other" taxes and the general sales tax for revenue. Selective sales taxes produce most of the revenue in Texas. The sales tax on motor fuel is the largest source of income, followed by license fees of various types and severance taxes

(mostly on oil and gas). Even with low prices and reduced production, Texas obtains about 6 percent of its tax revenue from severance taxes, collecting more than any other state except Alaska.

### Tax Patterns in the Major States

Examination of the tax patterns of the major states by four major types of taxes (property, general sales, individual income, and other) reveals sharp contrasts in the ways in which governmental activities are funded. Texas and Florida have no individual income tax; therefore, these states derive larger percentages of their total tax revenue from the remaining tax categories.

The five major states with the greatest dependence on the property tax as a source of tax revenue are New Jersey, Michigan, Texas, Florida, and Illinois. Nationwide, property taxes represent about 32 percent of total tax revenues. New Jersey and Michigan draw more than 40 percent of their tax collections from this source. Property taxes produce about 39 percent of Texas state and local tax revenue. Property tax rates vary sharply among Texas taxing jurisdictions.

General sales taxes make the largest contribution to the tax coffers of Missouri, Florida, Texas, Georgia, and Indiana. The national average for general sales taxes as a percentage of total taxes is about 24 percent. In Missouri, sales taxes provide over 42 percent of total taxes. The percentage for Texas is 33. The major states with the lowest dependence on general sales taxes are Virginia, Michigan, and Massachusetts.

Massachusetts, more than the other major states, relies on the individual income tax as a source of funds. More than 36 percent of tax collections in Massachusetts are from the individual income tax, while the national average is about 21 percent. Other major states with high income tax levels are North Carolina, Ohio, New York, and Virginia. Among the major states with an individual income tax, New Jersey ranks lowest. In this group, only Texas and Florida have no individual income tax. Florida's corporate income tax produces less than 3 percent of the state and local tax revenue in that state.

"Other" taxes make the largest contribution to tax revenues in Florida, Pennsylvania, Texas, Virginia, and North Carolina, among the major states. Nationwide, these taxes account for about 23 percent of tax revenues. In Texas, the contribution of these taxes is also 23 percent.

Several smaller states have been more successful than some larger neighbors in levying that most popular of all taxes, the "other fellow" tax. Noteworthy examples are Alaska and Wyoming, which obtain large portions of their tax revenue from severance taxes on minerals largely used by out-of-state customers, and Nevada, which collects a hefty portion of its taxes from visitors to Las Vegas and Reno.

— *Charles P. Zlatkovich*
*Associate Professor of Accounting*
*and*
*Karl B. Putnam*
*Associate Professor of Accounting*
*University of Texas at El Paso*

• • •

## The Future of the Maquiladora Industry: Lessons from Asia

The maquiladora industry has played a major role in the growth of one of the most underdeveloped areas in Texas, the Mexican border region. Maquiladoras have invigorated the border economy in ways hard to imagine twenty years ago. In El Paso, for instance, the maquiladora industry created a boom for engineering services, storage facilities, and transportation services.

The Mexican model of development is changing, more closely resembling those implemented in the newly industrialized countries (NICs) of Taiwan, Singapore, Korea, and Hong Kong. These changes will affect the maquiladora industry and, consequently, the Texas economy. By examining the labor-intensive industry in Asia, we can anticipate possible changes in the maquiladora industry in Mexico.

### Paths to Development

Three main elements define the NIC economic environment: (1) an export-oriented strategy; (2) strong encouragement to foreign

investment; and (3) Export Processing Zones (where labor-intensive manufacturing facilities locate), conceived as a *major* strategy in the economic development of the NICs. By contrast, for most of this century the economic development of Mexico has been based on (1) import substitution policies; (2) strong restrictions to foreign investment; and (3) labor-intensive assembly facilities (maquiladoras), considered a *marginal* program in the economic development of the country.

The path of the maquiladora industry, with its emphasis on exports and 100 percent foreign ownership, diverged from that followed, until recently, by the Mexican government. Until the 1980s, the economic strategy of Mexico was marked by inward-oriented policies. Within this environment, the maquiladora industry functioned as an enclave, marginalized and, until the 1970s, restricted to the border area. In fact, it was viewed primarily as a means to increase employment along the border for displaced bracero workers.

Mexico now follows a path of development more like the one that has characterized the NICs in Asia. For example, the Mexican congress recently enacted changes to various foreign investment laws and regulations that minimize restrictions on those investments. Also, the economy has become more outward oriented as a result of the liberalization policies implemented in the 1980s, when the country became a member of GATT, and the North American Free Trade Agreement (NAFTA), which became effective on January 1, 1994.

## The Case of Wages

In the 1960s, the NICs attracted mainly labor-intensive manufacturing, particularly from U.S. electronics companies, but their comparative advantage based on "cheap" labor has diminished in recent years as workers have become scarcer and more expensive (see figure). As a parallel case, the Mexican economy might be expected to show an increase in wages as development and investment increase as a result of NAFTA. How did the offshore assembly industry in Asia adjust to higher labor costs? The answer to this question might provide some indication of how the maquiladora industry in Mexico will adjust to expected increases in wages.

The Asian offshore assembly industry used basically four strategies to overcome higher labor costs. First, it relocated simpler activities to neighboring countries, in particular, to the so-called "near-NICs" (Malaysia, Thailand, and Indonesia) and to China. For instance, direct foreign investment (DFI) from Taiwan, Singapore, and Hong Kong increased from 28.4 to 34.0 percent in Malaysia between 1983 and 1988 and from 16.6 to 23.4 percent in Thailand between 1985 and 1987. Hong Kong alone accounted for 68 percent of total DFI in China in 1987.

This relocation did not inhibit the growth of the offshore assembly industry in the NICs. In fact, relocation was part of the second NIC strategy for overcoming wage increases: a process of regional specialization in which the near-NICs produce more labor-intensive products and the NICs specialize in the production of relatively more capital-intensive and higher value-added commodities. Taiwan and Singapore, for instance, moved from producing semiconductors and simpler consumer electronics to higher-tech products, such as computers and computer peripherals. The third and fourth strategies involved using more skilled labor and increasing automation. For example, after automating its Singapore assembly plant, Fairchild attained assembly speeds 40 times faster than those prevailing under the manual production regime.

The NIC experience proved that the cost of labor is less important than variables that affect productivity such as skills, trainability, and flexibility. The change from cheap to skilled labor manufacturing did not occur solely because of the response of manufacturing facilities to changes in the comparative advantages of these countries but also because of specific government policies designed to facilitate and encourage this transition. The NIC governments played a key role in providing labor skills and promoting the production of local inputs.

## Conclusion

How does the maquiladora industry in Mexico compare to the offshore assembly industry in Asia? In the very long term, as wages in more urbanized areas increase, some of the maquiladoras (especially those with few technological advances) may relocate to other Mexican regions where labor is cheaper and even, as economic and political conditions stabilize, to some Central American countries. Some maquiladoras have already implemented selected NIC strategies, such as reorganizing production processes to assemble more technologically sophisticated products and to use more skilled labor and computer-oriented

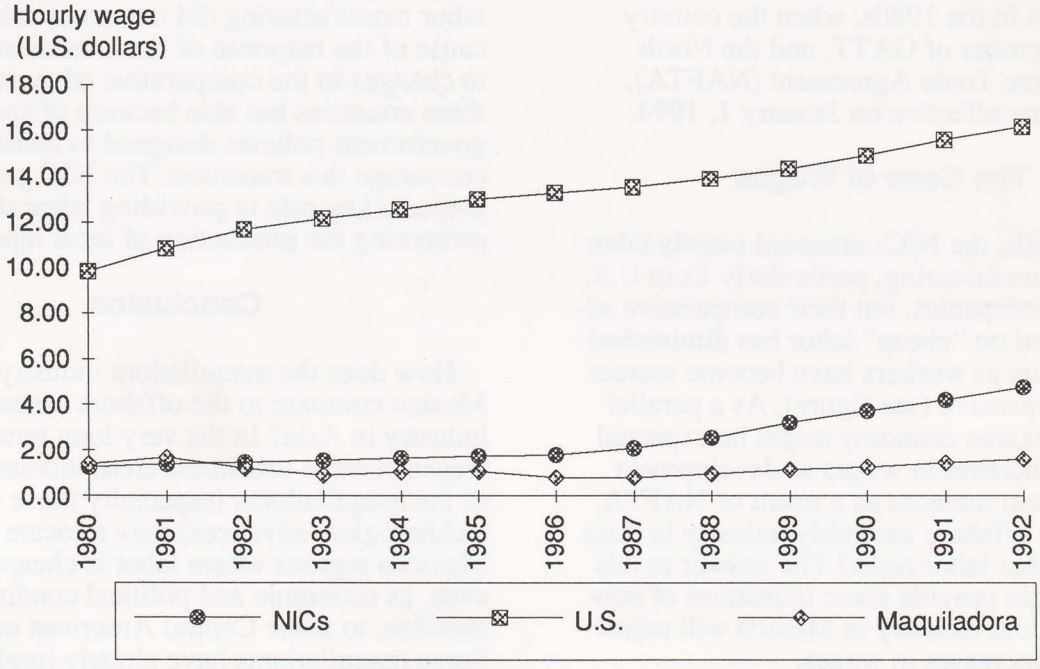
## Maquiladoras (continued)

machines. These changes were stimulated not by increases in wages, but by strong competition in the international market for the products that the maquiladoras assemble or in the market for the final products into which maquiladora components are incorporated. International competition—mainly in the electronics and automobile industries, the two sectors that account for the largest share of maquiladora operations—forced companies to reorganize their production processes along the "Japanese model of total quality management." In this production model, the final assembler and its web of suppliers (including some maquiladoras) must become "lean producers."

The maquiladora industry lags far behind in the organization of training programs. In the NICs, many of the programs are directed toward *re*training *skilled* labor, English is the lingua franca for teaching in some of the nations' technical schools, and manufacturers and government work in partnership to develop training programs. In contrast, training programs in Mexico are focused mainly on training *unskilled* labor, English is not a main component of most training programs, and no linkages exist between maquiladora training programs and those of the government. By conveying to the Mexican government the need to train unskilled labor *and* retrain skilled labor to develop the managerial and engineering skills specific to the maquiladora industry, to make English a priority in the educational system, and to develop plans jointly to accomplish these objectives, the maquiladora industry can initiate strategies that have worked well in Asia. The continuing development of the border region relies on the maquiladora industry taking a proactive, rather than a reactive, role in the process of change.

— *Elsie Echeverri-Carroll, Ph.D.*
*Head, Economic Development Program*
*Bureau of Business Research*

### Labor Costs




Sources: U.S. Department of Labor, Bureau of Labor Statistics, Office of Productivity and Technology, *Hourly Compensation Costs for Production Workers in Manufacturing, 34 Countries*, unpublished data, April 1990, and *Hourly Compensation Costs for Production Workers in Manufacturing Industries, Mexico 1975-92*, unpublished data.

## Announcements

•Because counties have been added to a number of Texas metropolitan areas, the Texas Employment Commission is conducting a major revision of employment data, and the figures we regularly publish were not available at press time. "Employment and Unemployment Rate by Metropolitan Area," with our own calculations of percentage change, will appear again in the June **Texas Business Review.**

•A new brochure describing the Bureau and initiatives for 1992–93 is now available. For a copy, call 512/471-1616 or fax 512/471-1063.

*Editor: Lois Glenn Shrout*
*Assistant Editor: Sally Furgeson*

*Texas Business Review* is published six times a year (February, April, June, August, October, and December) by the Bureau of Business Research, Graduate School of Business, University of Texas at Austin. Subscriptions to *Texas Business Review* are available free upon request, as are back issues.

The Bureau of Business Research serves as a primary source for economic and demographic data on the state of Texas. An integral part of UT Austin's Graduate School of Business, the Bureau is located on the sixth floor of the College of Business Administration building.



BUREAU OF BUSINESS RESEARCH
P.O. Box 7459
Austin, Texas 78713-7459

**Address correction requested.**