

Stable Budgeting Eludes State

By Mary Weidler

When our leaders sit down next year to begin work on the '06 budget, it will be déjà vu all over again. The governor and lawmakers know already that they'll face a significant General Fund shortfall – perhaps as large as \$250 million. Most of the band-aids they used to cover this year's \$330 million shortfall are temporary fixes. Since all of our growth taxes are earmarked for education, a rising economy will not be enough to lift the General Fund to adequate funding.

Over the past two years, 25-percent cuts to many General Fund agencies have seriously hampered the state's ability to provide even the most basic services. Maybe it's a blessing that our expectations are so low.

On the Education Trust Fund side, Alabama scrambles to balance education needs with fluctuating revenues that pay the bills in good economic times and starve the schools when the economy sours. Although many appear satisfied with the upcoming '05 education budget, the system is barely salvaged from the proration, near-proration and cuts of the past three years. Evidence abounds that our education system isn't up to speed: lack of funding for textbooks and technology, double-digit tuition hikes in higher ed, shortfalls in special ed, along with the costly requirements of No Child Left Behind.

Economists have a term for our predicament: “structural deficit.” In other words, we don't take in enough money from year to year to support state services at an adequate level. A primary reason for this built-in shortfall is that our state fiscal system has remained largely unchanged for decades. For a detailed explanation of this problem, read the “Structural Deficit” fact sheet at www.arisecitizens.org.

Eliminating Alabama's structural deficit is a massive undertaking. The following are examples of policy changes that would get the process started:

- Modernize the personal income tax to capture more revenue from higher-income people. This tax was well-designed for 1935, when the state began taxing incomes of \$3,600 or more. The average teacher salary was then around \$500, and only about 7,000 Alabamians earned enough to be taxed. We now begin taxing a family of four at an income of \$4,600, about one-quarter of the poverty line. We could bring the tax up to date by raising the top rate to 6 percent; increasing the income threshold to \$18,850 (the federal poverty line); and removing the deduction for federal income tax payments.
- Modernize the sales tax to capture revenue from what people are consuming today. Alabama's sales tax was last updated in 1959, when the tax on retail sales was extended to include amusements and entertainments. It was raised to 4 percent in 1963 but not broadened. Although spending patterns have shifted toward greater consumption of services, our sales tax continues to rely only on consumption of goods and entertainment. Researchers at the University of Tennessee – Knoxville's Center for Business and Economic Research estimate that in 2001 Alabama lost \$221 million in state sales taxes to a

combination of the shift from goods to services and the growth of e-commerce sales. In 2006, they estimate, Alabama will lose \$600 million because of these factors.

- Modernize the state property tax to capture a fairer share of revenue, especially from under-taxed timberland and large farms. Most states stabilize funding for state services by balancing income, sales and property taxes like three legs of a stool. Alabama turns a blind eye to a potential major source of revenue: We could double our property tax and still have the lowest rate in the nation.
- Adjust the corporate income tax by removing the deduction for federal income tax payments and lower the rate from 6.5 percent to 6 percent.
- Restore the state inheritance tax. Contrary to Washington fast-talkers, this is not a “death tax.” Death affects everyone, but great accumulated wealth comes into the hands of a few. The inheritance tax currently being phased out affects fewer than 2 percent of Alabamians who die in a year. It simply requires multi-millionaires’ heirs to pay something for the privilege of accumulating wealth in a stable, financially regulated society.
- Reduce earmarking to permit lawmakers the flexibility to create a budget that reflects current needs and priorities, not those determined in decades past.
- Exercise spending discipline. A simpler and more transparent budget would reduce opportunities for favoritism and focus attention on the greater public good.

Without a serious look at ways to reduce our structural deficit and create a fairer tax system, Alabama will remain stuck in a losing game – one step forward, two steps back.

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