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Resources for

Informed & Engaged Citizens - Strong Neighborhoods & Communities - Responsive Government

FISCAL CRISIS AND RACIAL DISPARITIES HIGHLIGHT THE NEED FOR TAX REFORM by Jerry Kloby

The Star-Ledger's report of July 25, 2004 underscores a point the ICS and other social justice organizations have been making for quite some time – that the heavy reliance on property taxes in New Jersey contributes to an overall system of taxation that disproportionately burdens lower- and middle-income families and the state's minority residents.¹

The study, conducted by Star-Ledger reporter Robert Gebeloff, examined tax assessment and sale prices in 66 towns in Essex, Middlesex and Union counties. It then compared the tax assessment to actual market prices and overlaid that information with demographic data obtained from the U.S. Bureau of the Census. The overall finding was that, in many cases, neighborhoods that are disproportionately black have a higher ratio of taxes to value, i.e. they are paying a higher rate of property taxes. To use Gebeloff's example, a \$200,000 home in a black neighborhood might be getting the same tax bill as a \$300,000 in a white neighborhood. Likewise, Gebeloff found that "in a dozen towns where the disparity is greatest, blacks are more than three times as likely to live in overtaxed neighborhoods."

How can these disparities be remedied? There are two main approaches. The first and more immediate step needs to be taken at the municipal level. This would require New Jersey's cities and towns to conduct more frequent revaluations. In the counties examined by the Star-Ledger, property revaluations typically had not been done in 15 years. More frequent revaluations would ensure that taxes more accurately reflect the market value of properties. This policy is already practiced in some places. Massachusetts, for example, requires its municipalities to update tax rolls every three years, and most towns in New Jersey's Somerset and Hunterdon counties do annual updates.

The second approach is a statewide reform of the tax system that would eliminate or sharply reduce regressive taxes such as property taxes, and replace them with pro-

gressive forms of taxation -- taxes that take more from those better able to pay. This is a much more long-term and comprehensive approach than simply conducting more frequent local property revaluations but it is necessary if states such as New Jersey are going to overcome inequity in taxation, inequity in spending for essential services such as education, and provide themselves with the revenue to overcome the fiscal crisis they face.

Fiscal Crisis

Over the last few decades states and municipalities have been increasingly struggling to provide needed services in the face of periodic fiscal crisis. A bad situation became worse over the past three years, pushing some states to the breaking point.

Consider the impact the state budgetary crisis is having throughout the nation. The state of Connecticut released prosecuting attorneys and Kentucky released prison inmates. Teachers in Oregon had to work two weeks without pay. Cutbacks in Nebraska caused nearly 25,000 mothers to lose health care, and college tuition was raised nearly 20 percent in two years. Other states have been dismissing state troopers, closing parks, cutting property tax rebates for senior citizens, and reducing transportation services. Texas, the state with the highest percent of its citizens not covered by health insurance, reduced health care eligibility for 275,000 children. And least six states have cut back on the amount of food they serve to prison inmates.²

According to the Center on Budget and Policy Priorities hundreds of thousands of people throughout the nation have lost Medicaid coverage due to state budget cuts. Most states cut aid to colleges and universities. Faculty layoffs, larger class size and higher tuition are among the consequences. A General Accounting Office survey found that 23 states reduced access to affordable child care since 2001.³

These cutbacks are insufficient to balance the budgets. Many states are still deep in the red. Meanwhile federal aid to states and municipalities has been diminishing for several decades. More recently, the Bush administration enacted tax breaks that further compromised government's ability to provide services to the needy and to maintain or develop essential infrastructure such as railroads and the electrical supply grid. More and more federal money goes to the military and for corporate subsidies while education, housing, income supports, and other essential services suffer (see figure 1 for a breakdown of federal spending).

Revenues Fall Short

States and municipalities are forced to step in and try to fill the gap – something they are not well-prepared to do. New Jersey, in particular, faces obstacles. For the past two years Governor McGreevey has struggled to balance the state budget. Why is there such a wide gap between revenues and expenses? The growing deficit is not a result of increased spending but mainly a result of revenue shortfalls due to a slumping economy.

According to the Center on Budget and Policy Priorities, state spending (on a per capita basis) rose more slowly during the 1990s (an average of 2 percent per year) than it had during the 1980s or, for that matter, the entire second half of the twentieth century. Most of the growth that did occur was in three main areas – education, health care and corrections. According to the Center, the current fiscal crisis is mainly due to steep drops in revenue.⁴

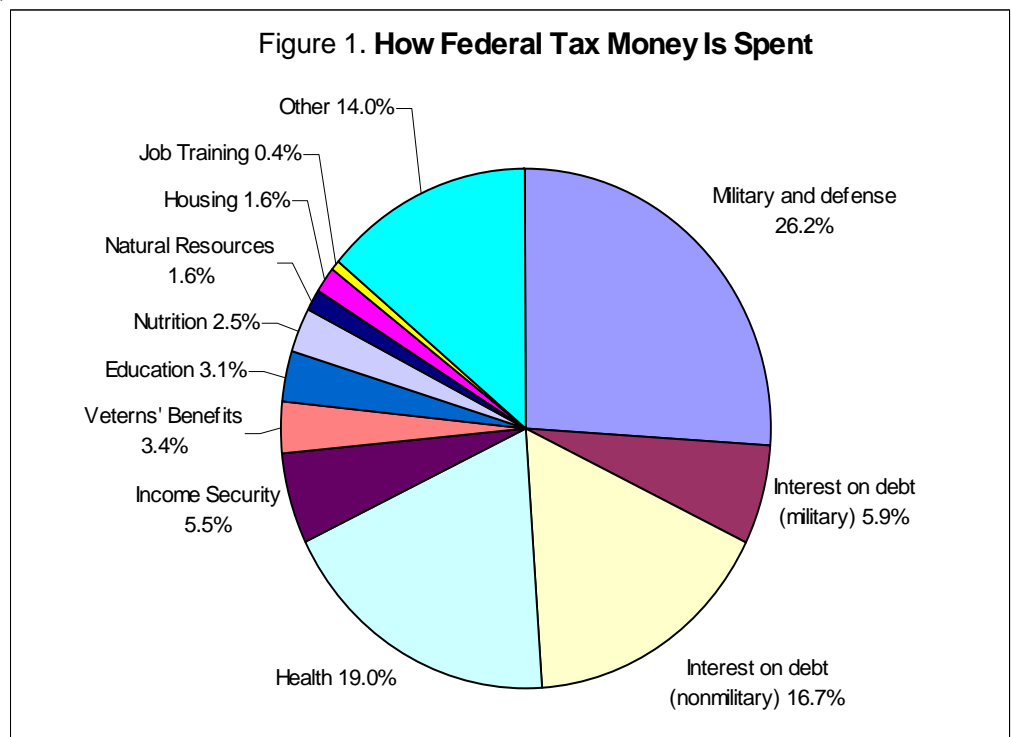
Two revenue problems are especially harmful to New Jersey, both in terms of the financial health of the state government and in terms of social and economic equity within the state. The first of these is the limited amount of money that comes back to New Jersey from the federal government. New Jerseyans are taxed \$9,535 per capita (in federal taxes) but receive only 67 cents for each tax dollar back from the federal government. This leaves New Jersey tied with Connecticut for the lowest funding from the feds (by contrast, New Mexico gets the highest amount returned, \$2.08 per dollar).⁵

The second problem is New

Jersey's own tax structure. Revenues from property taxes are insufficient to provide the money that municipalities need. Moreover, the property tax system creates serious inequities throughout the state in the ability to deliver services, particularly in regard to education. And the entire system contributes to growing inequality and more racial segregation – undoing the valiant efforts of many of the state's residents and the courts. Municipal governments, which get the bulk of their revenue through property taxes, are ill-equipped to cope with the increasing financial demands.

Since municipalities raise most of the money they spend for education from property taxes this sets the basis for destructive inequities in school systems. Poorer cities are not able to generate sufficient revenues to fund school systems capable of meeting the educational needs of their residents. Wealthier suburbs, on the other hand, are able to meet the funding needs of their schools – schools attended by students who already have an advantage due to the greater resources of their families.

New Jersey is highly segregated. The Newark metropolitan area is one of the five most segregated metro areas in the nation.⁶ And, according to John A. Powell, executive director of the Institute on Race & Poverty, New Jersey is more racially segregated today than before the historic Mt. Laurel decision in 1975. Poverty is also concentrated in the state's largest cities. The impact of poverty and residential segregation falls harshly on the young people of the state. In New Jersey, 63 percent of poor children would have to change schools to achieve an iden-



tical mix of poor and non-poor students. Likewise, 69 percent of minority students would have to move to achieve an identical mix of minority and non-minority students in each school.⁷

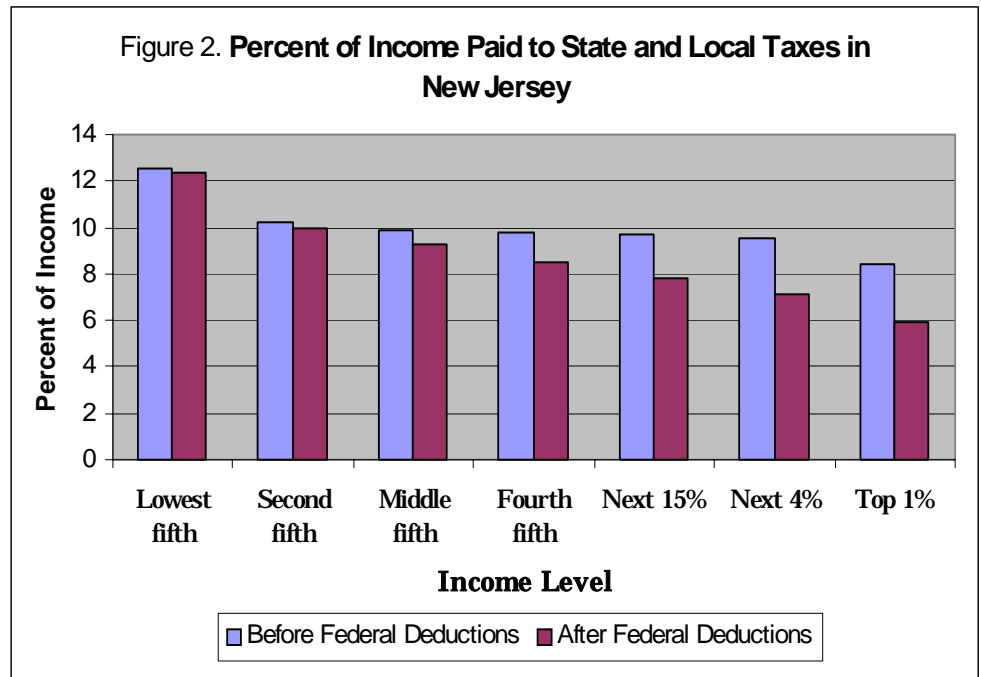
Ironically, property tax rates are higher in towns with a disproportionate number of poor and minority residents. In New Jersey, municipalities where blacks and Hispanics make up over 90 percent of the elementary school students have property tax rates that average 3.7 percent compared to a 2.1 percent property tax rate in towns that average just 2 percent blacks and Hispanics in the elementary school system.⁸

Equity in school funding is one of the most compelling reasons to move away from the property tax system. Another reason is the role that property taxes plays in overdevelopment and the ever-increasing problem of congestion.

Many municipalities, in fear of raising the ire of their residents, attempt to increase revenues by developing new properties rather than raising taxes on already developed ones. This “chase for ratables” results in the development of shopping malls, office parks, new housing, etc., in formerly open or green space, and in highly developed urban and suburban regions. One of New Jersey’s most striking characteristics is the dearth of public space in developed areas. Parks are often small, neglected, and located on the outskirts of urban areas. Likewise, gathering places in the form of public squares and markets are few and far between, to the detriment of social and civic life.⁹

A Regressive Tax System

Heavy reliance on property taxes is one of the main reasons that the New Jersey tax system is so regressive. In New Jersey, the poor pay a higher percent of their income in state and local taxes than do middle and high income households. According to the Institute on Taxation and Economic Policy, the lowest fifth of the state’s residents pay 12.5 percent of their income to local property taxes, state sales tax, excise taxes and state income tax. The middle fifth pays 9.9 percent and the top 1 percent (incomes over \$571,000) pay 8.4 percent. However, the IRS allows taxpayers to deduct state income taxes and property taxes from their federal returns. This offers no significant benefit to the lowest income earners but it reduces to 5.9 percent the proportion of income that the top



1 percent pay for state and local taxes (see figure 2).¹⁰

New Jersey is more dependent on property taxes than any other state. New Jersey municipalities receive 52 percent of their revenue from property taxes, compared to the national average of 27 percent.¹¹ Other states have moved away from funding schools through property taxes. The state of New Mexico, for example, pays 100 percent of the school budget of its municipalities. And in 1994, Michigan’s state government moved from funding 20 percent of local school budgets to funding 80 percent.¹²

The inequity in taxes and in services is compounded by tax and spending policy on the national level. The federal government, for example, is imposing on the state the No Child Left Behind Act that demands higher performance from our schools but provides very limited resources to attain the higher standards. In fact, the overall federal contribution to education in New Jersey is appallingly low (shown in figure 1). The same is true in regard to the federal government’s contribution to ensuring the supply of decent affordable housing. Of the \$5,184 in federal taxes paid by the median NJ household, nearly \$1,400 is spent for military and defense, nearly \$1,200 goes to pay interest on the national debt, but only \$163 is spent for education and just \$83 for housing.¹³

Unmatched Inequality

Nationally, the data on wealth and income inequality point to some shocking inequities that are continuing to grow. Income inequality in the United States is currently greater than any time since reliable statistics have been gathered, and greater than any other of the world’s most economically advanced nations (see figure 3). It has reached record

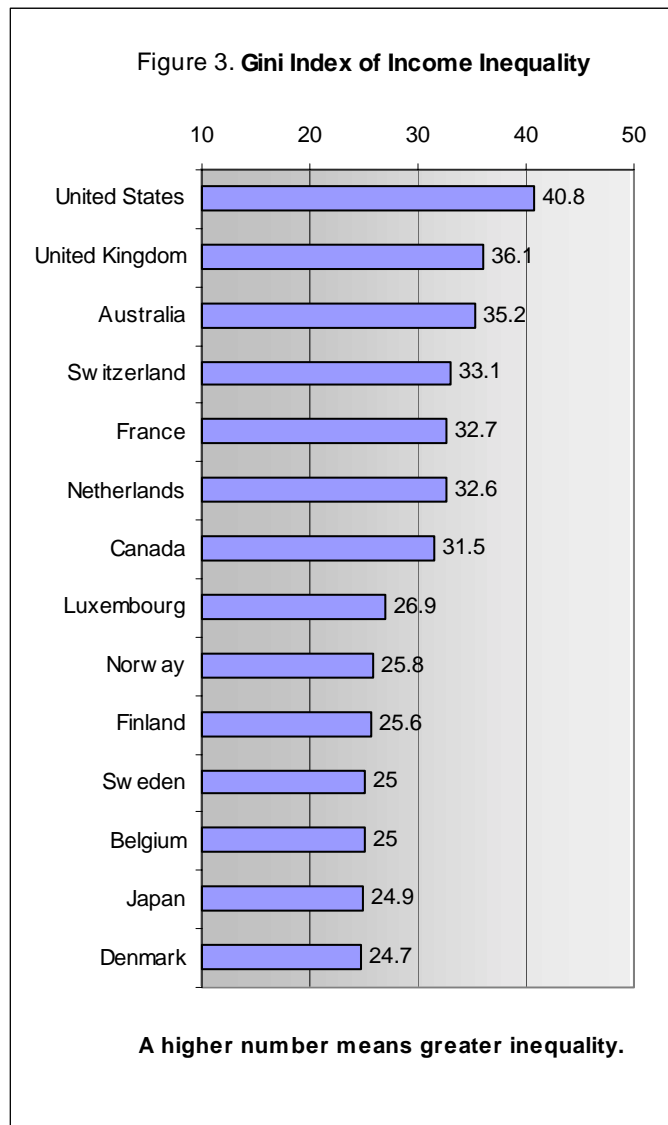
proportions and is likely to continue to worsen due to three main factors: 1) A continued weakness of the working class, as indicated by low unionization rates, job losses and a declining minimum wage. 2) Increased tax cuts for the wealthy. And 3), the rise in federal and state debt, which will put a greater burden on working- and middle-class income earners for many years to come.

In the year 2000, the 400 wealthiest Americans received more than 1% of all the income in the United States – more than double their share in 1992. Their average income was \$174 million – nearly three times more than in 1992. The very richest pay just 22.3 percent of their income in federal income taxes, down from 26.4 percent in 1992. More higher income Americans are paying no income tax. In addition, the tax rate on capital gains was recently reduced for the second time in seven years. The tax rate was cut from 28 percent to 20 percent in 1997, and then to 15 percent in 2003.¹⁴

In September of 2004, President Bush informed the nation that remaining in Iraq next year will cost another \$87 billion. This is more money than the combined state budget deficits for all fifty states. An astute *New York Times* reporter commented that “many of those who will actually pay that bill were unable to watch [the president’s address to the nation]. They had already been put to bed by their parents.”¹⁵

Debt-financed government spending also contributes to inequality as the interest payments on the debt primarily go to the wealthy. In 2002, interest payments on the federal debt amounted to roughly \$200 billion dollars. Add this to the list of corporate subsidies that cost Americans an estimated \$85 billion to \$448 billion and its no wonder Americans are upset about their taxes. But it may not be so much the *amount* we pay in taxes that is galling but rather, *how* the money is spent. Taxes in many European countries are higher than in the United States, but citizens there tend to complain less due to the superior benefits they receive (see figure 4 for tax rate comparisons).

By some measures New Jersey is the richest state in the nation. For the year 2002, New Jersey led the nation in median household income (\$58,759) and median family income (\$70,488).¹⁶ The state faces serious fiscal and social problems not because of a lack of resources and not because of a lack of know-how. The state faces these problems because of an unwillingness to challenge the political power of the privileged and the system of inequality that permits some of the state’s population to find individualistic solutions to these problems. But for many of the rest of us it is simply an illusion that one can move to a better community without having the problems



of congestion, poor schooling, segregation, fiscal crisis, etc., follow us.

Remedies are needed on both the national and the state level. Local voices calling for the abolition of county government or for the secession of municipalities from counties (such as the movements in Montclair and Millburn to leave Essex County) may be raising some valid concerns but in the long run these actions could further divide and harm the state’s residents. Ultimately, regional government may provide much fairer and fiscally sound alternatives. But a statewide plan is also needed that would simultaneously slash municipal property taxes while increasing state revenue through a more progressive income tax and other sources. The state would have to immediately share new revenues with municipalities in proportion to their reduction in property taxes. The New Jersey Policy Perspective has offered a number of proposed steps to move the state in this direction.¹⁷

National priorities need to be changed as well. Recent

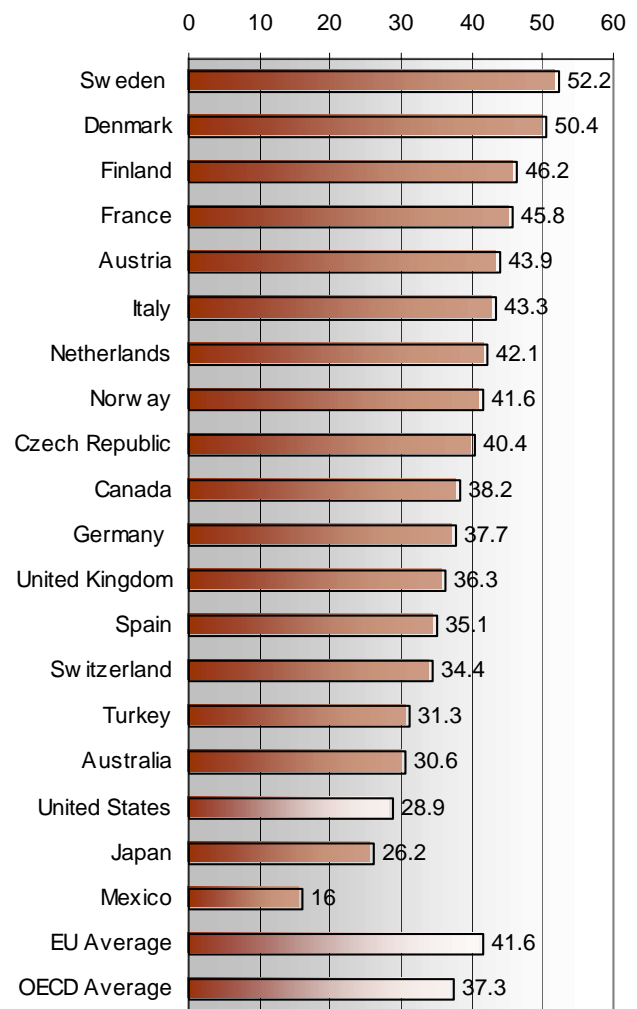
tax cuts for the wealthy should be rescinded. Putting money in the pockets of people who will spend it (middle- and lower-income Americans) will do more to boost the economy than tax cuts for the wealthy and subsidies for corporations who are already awash in capital.

Endnotes

- ¹ Robert Gebeloff, "Black Homeowners Overtaxed in 3 Counties," *Star-Ledger*, July 25, 2004.
- ² Timothy Egan, "States, Facing Budget Shortfalls, Cut the Major and the Mundane," *New York Times*, April 21, 2003. And, Fox Butterfield, "States Putting Inmates on Diets to Trim Budgets," *New York Times* September 30, 2003.
- ³ Center on Budget and Policy Priorities, "Severe State Fiscal Crisis May Be Worsening." May 9, 2003.
- ⁴ Center on Budget and Policy Priorities, "Did States Spend Their Way into the Current Fiscal Crisis?" August 1, 2003.
- ⁵ www.publicagenda.org
- ⁶ The New Jersey Public Policy Research Institute, *The State of Black New Jersey*.
- ⁷ Myron Orfield and Thomas Luce, *New Jersey Metropatterns*, Minneapolis: Ameregis, April 2003, p. 12.
- ⁸ Data provided by the New Jersey Regional Coalition.
- ⁹ See Ray Oldenburg's *The Great Good Place* and Benjamin Barber's *A Place for Us: How to Make Society Civil and Democracy Strong* for excellent arguments about the importance of public space. Both books are reviewed on the ICS Web site: www.communityknowledge.net.
- ¹⁰ Institute on Taxation and Economic Policy *New Jersey Taxes Hit Poor & Middle Class Harder than the Wealthy*, www.itepnet.org/wp2000/nj%20pr.pdf
- ¹¹ Orfield and Luce, *Metropatterns*, p. 2.
- ¹² Dean Rusk, conference on Regional Equity, July 27, 2003; Rutgers, Douglas College.
- ¹³ National Priorities Project, "Tax Day 2003, New Jersey," www.natprior.org/
- ¹⁴ David Cay Johnston "Very Richest's Share of Income Grew Even Bigger, Data Show" *New York Times* June 26, 2003. And "The 400 Individual Income Tax Returns Reporting the Highest Adjusted Gross Incomes Each Year, 1992-2000" IRS Statistics of Income Bulletin, Spring 2003, Publication 1136.
- ¹⁵ David Firestone, "Dizzying Dive to Red Ink Poses Stark Choices for Washington," *New York Times*, September 14, 2003.
- ¹⁶ Bureau of the Census, www.census.gov/acs/www/Products/Ranking/index.htm
- ¹⁷ Jon Shure, "Upside Down and Backwards: Taxes in New Jersey," www.njpp.org/upsidedown.html
- ¹⁸ *The Week*. "Trouble in Swedish Paradise." October 24, 2003.

Taxes are generally much higher in European nations in comparison to the United States (yes, the U.S. figures include federal, state and local taxes), but citizens enjoy a much broader range of social benefits including full health care and paid maternity leave. There is also much less support for cutting taxes in Europe. In fact, one Swedish pollster remarked that calling for tax cuts while campaigning for office in Sweden is "like swearing in church."¹⁸

Figure 4. Taxes as a Percent of GDP



Source: "OECD in Figures, 2002"

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