A PROPOSAL:

TOWARD A KINDER AND GENTLER RESIDENTIAL PROPERTY TAX

by

JOHN MERRIFIELD*

April 14, 2006

Abstract

Local governments in most states levy a real property tax and most of them determine the tax base through a periodic reappraisal (PR) of properties based on sales of comparable properties. A few states, most notably California and Florida, replaced the PR approach with taxation based on acquisition value (AV = purchase price) with an annual inflation adjustment.

The objective of the proposed research is to compare periodic appraisal (PR) and AV on several dimensions. The hypothesis that motivated this endeavor is that a rigorous theoretical and empirical analysis will destroy myths about revenue yield and equity that underlie failure to more widely replace PR with the 'kinder and gentler' AV approach.

Compared to the much more widely used periodic appraisal (PR) approach to residential property tax base determination, the acquisition value (AV) approach: 1.) Has lower administrative costs; 2.) Promotes non-governmental responses to rehabilitation of blighted properties, and restoration and better upkeep of historic properties; 3.) Prevents higher property values from forcing people to sell and leave their homes, a well-documented, direct assault on individual liberty; 4.) Reduces neighborhood homogeneity; 5.) Reduces the cost of home improvements; and 6.) Eliminates the bias against improvements most visible to tax assessors; exterior improvements that boost neighbors' property values.

By taxing property improvement, especially exterior improvement, PR penalizes personal responsibility for property maintenance, which diminishes neighborhoods, and hurts the value of other properties. That's why, contrary to virtual knee-jerk assumption, replacing PR with an AV policy may not reduce the property tax base. Indeed, an AV approach could gradually yield more tax revenue from residential properties than the PR approach would have produced. The proposed empirical analysis will address that issue.

An acquisition value (AV) approach causes similar properties to bear unequal tax burdens, but the superiority of periodic appraisal (PR) on that issue of horizontal equity may not be as large as is typically assumed. The proposed research will also address that issue, and offer AV-PR hybrids that combine advantages of both approaches.

The empirical analysis entails a significant data collection effort; annual data for Assessed Value of Residential Property for Tax Purposes (AVRP) for the AV states, and for several PR states, and data for key determinants of AVRP.

* Professor of Economics, University of Texas – San Antonio, 78207. Office: 210-458-2519. FAX: 210-458-2515. E-mail: john.merrifield@utsa.edu

PROJECT DESCRIPTION

A PROPOSAL:

TOWARD A KINDER AND GENTLER

RESIDENTIAL PROPERTY TAX

I. Introduction

Typical residential property value assessment practices impose costs that have not been empirically measured. Even though some states have recently reformed, curtailed, or abolished real property taxation, many of the key effects of the typical policies are still not even widely recognized. For example, the assertion that Texas' residential property tax policies were a home improvement deterrent surprised a state legislator. He said the issue had not come up in the legislature.

Rapidly rising residential property values prompted California (Prop 13) and Florida to limit assessed value increases between property transfers. Both sides of the Prop 13 debate assumed that the limits on assessment growth would severely impact property tax revenues. Still, California and Florida voters opted for reform to spare families the injustice of being taxed out of properties purchased for much less than prevailing property values. Now the same justice vs. funding for public services issue has arisen in several other states (see attached 7/13/04 *WSJ* article, and 4/04/06 *WSJ* editorial). The assumption that the kinder and gentler CA/FL approaches reduce revenues significantly, and failure to widely recognize other costs of the typical residential property tax regime (benefits of a kinder, gentler regime), helps keep kinder, gentler approaches from spreading. The kinder and gentler alternatives include assessment based just on acquisition value, capped increases in assessed value, and deferments of payments on property value increases until the property is sold.

The key aim of the proposed research is to test the assumption that the typical residential property value assessment policy produces more revenue than the kinder, gentler assessment approach adopted by California and Florida. I will also discuss administrative costs and the horizontal equity issue, which means equal taxation of equal properties.

The next section of this proposal describes the typical residential property assessment policy, what it aims to accomplish, and its major shortcomings. Section 2 identifies some reasons to believe that kinder, gentler property tax regimes may not reduce assessed value growth, and may increase it. Section 3 describes the kinder, gentler approach that some states have adopted. Section 4 describes the empirical model that I propose to develop, and then use to test whether, as is widely assumed, typical regimes achieve more rapid residential property tax base growth. The analysis focuses on the residential property tax base; in other words, the assessed value of residential property (AVRP). Section 5 describes the data to be sought and analytical issues to be confronted. Section 6 is a detailed budget.

II. The Typical Property Tax Regime

Periodic revision of each property's assessed value is the key feature of the typical property tax regime. Between title transfers, the tax assessor uses data like recent sales of comparable properties, spending on improvements, and judgment to revise each property's assessed value for tax purposes.

Horizontal equity is a primary justification of the periodic reassessment (PR) policy's widely recognized high administrative costs, and the potential for forced property sales and family relocation, or painful disposable income reallocation. But substantial horizontal inequities will survive periodic reassessment (PR). Since tax assessors typically do not have access to the interior of the structure, hidden improvements and repair needs hinder pursuit of the horizontal equity goal. In addition, allegedly comparable properties often differ significantly. The resulting protests further depress taxable values and divert skilled labor resources from productive pursuits into a property value protest industry. And the resulting need to talk down the assessed value of property before the taxing authorities and then laud the property's virtues to potential buyers is an assault on public morality and ethics.

Note also that the increased wealth that results from property value growth is illiquid, and to a high degree useless to the homeowner. The increased property value benefits the owner only if: 1.) They sell and move to an area with less property value growth, or; 2.) They consume less housing, or; 3.) They can service the extra debt they can incur by borrowing against the increased equity.[1] So, a periodic reassessment policy taxes increased paper wealth that has a very limited connection to increased real affluence. Indeed, until the property is sold the real connection to affluence is negative. Homeowners have to pay more to keep what they already own. And certainly the PR policy is an immediate tax on property improvement, and thus ultimately reduces total property value.

The most widely cited justification of periodic reassessment (PR) is that it yields more tax revenue. Failure to constantly update assessed values would supposedly force spending cuts, rate hikes, or greater reliance on other taxes. But the side effects of the PR policy suggest that PR may not produce more revenue than alternatives that don't include PR. PR reduces property improvement effort by raising the cost of home improvements that the tax assessor can detect prior to sale. For example, suppose a homeowner makes a visible $1000 home improvement. With a property tax rate of, say, three percent per year, that improvement will cost an additional $30/year in higher taxes for as long as the current owner holds the property. The effect is worse for improvements that are worth much more than they cost. For example, suppose a homeowner spends $10,000 to refurbish and paint the exterior. With good taste and skill, and some do-it-yourself participation in the project, the paint job could increase the property's market value much more than $10,000. Suppose that the tax assessor decides the repainted house is worth $50,000 more than before. With a three percent property tax rate, the paint job costs an additional $1500/year in property taxes.

So, according to the Law of Demand, periodic reassessment (PR) reduces home improvement spending. Since PR affects visible, exterior improvements the most, the value of adjacent properties is probably also affected. In other words, it most heavily taxes improvements that neighbors may enjoy (and cash in on to some extent when they sell) almost as much as the owner of the improved property. Subsidy is the efficient public policy for significant positive spillovers, but periodic reassessment taxes positive spillovers.

Some improvements are more visible to tax assessors than others, and the effect on total improvement cost depends on how close to sale an improvement occurs. Therefore, periodic reassessment distorts home improvement spending towards interior upgrades that produce no beneficial spillover effects, and it biases improvement spending towards the end

[1] For example, my mother's house is worth at least ten times what she paid for it. That's true for her entire area. If she sells the property and moves to comparable property in her neighborhood, she gains nothing. To partially cash in on the gain, she'd have to leave her home area, or move into a much smaller residence.

of ownership tenure.[2] Periodic reassessment also biases improvement efforts towards undocumented do-it-yourself efforts that may not be as value enhancing in the long run as professional work documented by contracts or permits known to the tax assessor.

If the tax assessor is right about the $50,000 jump in value, the $10,000 paint job seems like a great investment even with the higher taxes. But the homeowner can exploit the higher property value only by selling the property, or by borrowing against the increased equity. With periodic reassessment (PR), homeowners that make visible home upgrades reduce their disposable income every year thereafter; long after completing payment for the improvement work and materials. Since property value enhancements don't change the owner's ability to pay higher taxes, homeowners can improve their property to the point where higher taxes would force them to sell it.

A forced sale is more likely without any action by the owner. Indeed, competition to live in a popular area can drive up property values enough so that higher taxes force longtime residents to leave the area (see the attached 7/13/04 *WSJ* article). Such effects and the fear that they would spread were responsible for the pressure to end the practice in California and Florida (CA/FL) despite the assumed tax revenue loss.

So, it's an empirical question, and the key empirical issue is whether the CA/FL-like acquisition value (AV) assessment alternative yields more, less, or equal property value to tax than the typical regime that practices periodic reassessment? After the next section, which discusses the AV assessment alternative to PR, the empirical issues are addressed.

III. Kinder, Gentler Approaches

In a pure acquisition value (AV) assessment regime, assessed values stay at the purchase price. Only property additions warrant a reassessment; usually the construction cost. An AV policy creates horizontal inequities between comparable properties that are held for different lengths of time. But, it has major advantages as well. An acquisition value-based assessment policy creates a strong incentive to acquire and refurbish run-down properties. That's especially important for older, sometimes historic neighborhoods. The condition and longevity of the structures in those neighborhoods is a public good. AV eliminates the tax penalty for visible home improvements; the kind that neighbors can enjoy, and that raise property values throughout neighborhoods. With PR, rapidly rising property values can drive up property levies enough to force some people to sell. An AV-based regime eliminates the anguish of forced relocation, and thus enhances neighborhood diversity. And AV-based residential property taxation retards the income level homogenization of older neighborhoods.

To capture some extra dollars and reduce horizontal inequities, California and Florida automatically adjust assessed values upward by a small amount each year. California's Prop 13 sets the annual change at two percent. Florida sets the annual rise at three percent or inflation, whichever is less. Since the adjustment isn't a function of anything the owner does, the adjustment doesn't make improvements more costly. Since the low rates of increase approximate likely growth in the ability to pay additional property taxes, the automatic adjustment feature isn't likely to raise anyone's tax bill enough to force them to move.

Since both existing approaches (PR and AV) to residential property value assessment suffer significant shortcomings, the proposed research will include the development of a hybrid approach that defers taxes on property value gains until those gains are realized with the sale of the property.

[2] 'They must be planning to sell' is almost a knee-jerk assumption about major home improvement efforts.

IV. The Empirical Model

To test the null hypothesis that periodic reassessment (PR) does not create additional property value to tax, the model must use a panel data set to find the relationship between the assessed taxable value of residential property (AVRP) and a 'dummy variable' for periodic reassessment. That means that the PR variable is represented by a one for each year in which a particular state had a periodic reassessment policy, and zero for each year in which a particular state did not practice periodic reassessment. A panel data set is a mixture of time series and cross-section data, which means data for several years for each of several states.

Naturally, AVRP will vary with many other factors other than PR. The appropriate control variables certainly include per capita income, population density, and population change. Density is a proxy for land prices. More rapid population change puts upward pressure on property values. The demand for housing also depends on household size, but those data are not available annually.

Because rate increases cause the tax base to be lower than it would otherwise be, a statewide average residential property tax rate is another appropriate control variable. And a model estimated from pooled cross-section, time series data set must also account for changes over time. They include finance rates and policy changes like income tax treatment of capital gains from sale of a home and assessment practices other than PR; for example, assessment ratios and the aggressiveness of periodic reassessments. Some states with a PR policy do not aggressively pursue reassessment, or like Texas they may cap the annual rate of increase in a property's taxable value. There are periodic surges, for example, when government budgets tighten.

Since it is not entirely clear whether PR should better explain the AVRP level, or the change in AVRP over time, there are two empirical models.

$$\text{AVRP} = f(\text{POP, DENSE}, \Delta\text{POP, PCI, TAXRATE, INTRATE, PR, DUMMIES}) \qquad (1)$$

Where:

AVRP = Assessed Value of Residential Property for Tax Purposes.
DENSE = Population Density
POP = Population
ΔPOP = Change in Population $((POP_T/POP_{T-1}) - 1) \times 100$
PCI = Per Capita Income
TAXRATE = Average Residential Property Tax Rate
INTRATE = Most Widely Available, Consistent, Housing Related Interest Rate
PR = Periodic Reassessment, 1 = Yes, 0 = No
DUMMIES = for each of N-1 states and differences in assessment policy (except PR) and income tax treatment of capital gains from the sale of residential property.

For the second model, the data are converted into percentage changes. The population change variable becomes $\Delta\Delta$POP, to reflect an acceleration or deceleration in the population growth rate. ΔDENSE and ΔPOP are perfectly correlated, so the specification includes only ΔDENSE.

$$\Delta AVRP = f(\Delta DENSE, \Delta\Delta POP, \Delta PCI, \Delta TAXRATE, \Delta INTRATE, PR, DUMMIES) \qquad (2)$$

Where:

$\Delta AVRP = ((AVRP_T/AVRP_{T-1}) - 1) \times 100$
$\Delta DENSE$ = Change in Population Density, $((DENSE_T/DENSE_{T-1}) - 1) \times 100$
$\Delta\Delta POP = ((\Delta POP_T/\Delta POP_{T-1}) - 1) \times 100$

Since the existing theory says little or nothing about the functional form or lag structure of relationships, some sensitivity analysis will explore those issues. Likely, additional literature review will prompt some additions to the righthand side of (1) and (2).

V. The Data Set

Since much of the literature review is already complete, compilation of the data set will be the first major phase (Summer, 2006) of the proposed research. Most of the data are readily available; for example, DENSE, POP, PCI, INTRATE, and the DUMMIES. But some AVRP and TAXRATE data, especially for the few AV states, will be more difficult to compile.

The first step will be to determine how many states may have usable AVRP data. Usable, first and foremost, means available and affordable. Some preliminary efforts have determined that for many states it will be more than a trip to the library, an online search, or even a letter to a not easily identified public official. It may take several phone calls to have the data compiled, and still more calls to learn critical data nuances and limitations. Key nuances may include factors like changes in assessment ratios, changes in home sale disclosure rules, policy changes including assessment practices, annual caps on assessment increases, and other changes in data definitions.

Ultimately, such nuances and limitations may force some available numbers to be excluded from the data set. Some property tax states may ultimately be completely absent from the data set. In other cases, data for certain years may be useful, while other years of data may not be usable. To safeguard the credibility of the research findings, such exclusions and omissions will have to be carefully documented, including sensitivity analysis, and justified in considerable detail.

VI. References

1. Adams, Charles. For Good and Evil: The Impact of Taxes on the Course of Civilization. (Madison Books, 1993).
2. Foldvary, Fred E. "The Ultimate Tax Reform: Public Revenue from Land Rent," Heartland Institute Policy Study No. 91 (December 3, 1998).
3. Gilliland, Charles E. "Owner's Revolt in State's Future," Tierra Grande 1065 (Spring, 1995).
4. Owens, Robert W. "Valuation and the Property Tax," The Appraisal Journal 68, #3 (July 2000): p 340-350.
5. Timberg, Craig. "Broken Promises on Tax Breaks," Washington Post (March 4, 2002): p A01.
6. Sexton, Terri A., Steven M. Sheffrin, and Arthur O'Sullivan. "Proposition 13: Unintended Effects and Feasible Reforms," National Tax Journal 52, #1 (March, 1999): p 99-111.
7. Sirmans, G. Stacy, Barry A. Diskin, and H. Swint Friday. "Vertical Inequity in the Taxation of Real Property," National Tax Journal 48, #1 (March, 1995): p 71-84.
8. Veasey, R. Lawson. "Heaven or Hell: What Fate Awaits Post-Property Tax Arkansas?" Arkansas Business and Economic Review 33, #1 (Spring, 2000): p 1-6.
9. Williamson, Richard F. and Sam M. Chappell. "Tax Assessment of Special-Purpose Properties: Use Value versus Market Value," The Appraisal Journal 65, #4 (October, 1997).

VII. **Statement of publication type and target**:

Top Peer-Reviewed Academic Journal: ***The National Tax Journal***

VIII. Summary of Workplan

Year 1 (2006): Mostly Summer and Winter Break.

A. Collect and Evaluate Data; Avoid Numbers Masquerading as Data
B. Update Literature Review

Year 2 (2007 + first two weeks of 2008): Mostly Summer and Winter Breaks.

A. Econometric Analysis
B. Write First Draft
C. Solicit Comments, Including Seminars, and Public Choice and/or an Economics Conference
D. Submit 'Final' Draft as Manuscript to ***Journal*** (January, 2008).

IX. Detailed Budget for June 5 (Monday), 2006 – January 14 (Friday), 2008

Research Funding for PI: $13,905

$4500 for 1/2 month (Summer, 2006)
$2350 for ¼ month, 06/07 Winter Break*
$7000 for 3/4 month (Summer, 2007)*
$2400 for ¼ month, 07/08 Winter Break*

* allows for 3% salary increase between academic years.

Graduate Student, Research Assistant: $2200 ($11/hr for 10 hrs/week for twenty weeks)

Consulting: $800

Office Supplies: $200

Telephone and Buy Data: $700

Total Cost: **$20150**

X. Appropriate Referees

Dr. John Mutti
Department of Economics
1210 Park Street
Grinnell College
Grinnell, IA 50112

Dr. Gordon Tullock
Department of Economics, MSN 1D3
George Mason University
Fairfax, VA 22030

Dr. George Zodrow
Department of Economics, MS-22
Rice University
6100 Main Street
Houston, TX 77005-1892

Peter Mieszkowski
Economics Department
Rice University
6100 Main Street
Houston TX. 77251-1892
fax 713-348-5278
telephone 713-348-3453

Those four individuals gave permission to be listed. Dr. Tullock also suggested Dr. Alexander Tabarrok, also at George Mason. He has not responded to my request for his permission to be listed as a referee.

Dr. Alexander Tabarrok
Department of Economics, MSN 1D3
George Mason University
Fairfax, VA 22030

XI. Applications Submitted or Pending Elsewhere: **None**

ATTACHMENT: July 13, 2004 *Wall Street Journal* article.

I thought I'd append an article from the July 13, 2004 *Wall Street Journal*. I believe the article adds weight to my claim that the proposed research is quite relevant to 'front-burner' public policy issues, and that the assessment practices of most states have been a source of significant injustices and inefficiencies and could continue to be.

To reduce the demand on your time, I have deleted article paragraphs not directly relevant to my Proposal, and highlighted especially relevant points in the article. The on-line version of the article is also full of 'links' that did not cut and paste well. Therefore, I omitted those links.

"Property-Tax Rise Triggers Backlash in Some Areas"

Homeowners, Legislators Move to Limit Big Increases Used for Funding Shortfalls

By **RAY A. SMITH**
Staff Reporter of THE WALL STREET JOURNAL
July 13, 2004 10:49 p.m.; Page A1

In an election year in which national candidates have focused on issues such as jobs and the war in Iraq, many voters are ***rebelling over an issue closer to home: a huge jump in their property taxes***.

In many parts of the country in recent years, strapped local governments ***have imposed big increases in*** property-tax rates, as well as ***in home assessments***, to fill budget shortfalls. In response, voters have organized efforts to repeal or slow property-tax boosts in states from Virginia to Oregon, in some cases with the support of frustrated local officials.

Nationwide, property taxes -- used to fund everything from police and fire departments to schools and recreational services -- rose an average of more than 10% between 2001 and 2003, estimates Joseph M. Mulcahy, a national deputy managing principal at Deloitte & Touche LLP's Property Tax Services Group. ***In some municipalities, he says, home assessments have gone up between 20% and 50%***.

Particularly hard hit have been some desirable and growing suburban areas outside major metropolitan areas, where home prices and assessments have been on the rise. In a survey of such suburbs outside 12 major cities across the country, Runzheimer International, a management consulting firm based in Rochester, Wis., found that ***property taxes rose an average of 23.3% between 2000 and 2004***.

For many homeowners, the increases have eaten into benefits they gained from President Bush's cuts in federal income taxes. Mark Zandi, chief economist at Economy.com Inc., a research firm in West Chester, Pa., estimates that nearly a fifth of the income-tax benefit

Americans are receiving from federal tax cuts this year is going to pay for higher property taxes. Mr. Zandi says he expects property taxes to continue rising "very rapidly."

Over the same period, assessments rose rapidly, thanks to the housing boom. The median price of an existing single-family home rose to $170,000 from $147,800.

Alexander J. Aitken, a 56-year-old pilot for American Airlines, says that taxes on his four-bedroom, two-story home in Culpeper County, Va., rose 45% in 2003 from the year before, to $6,000. The 2003 figure was 237% higher than it was when he bought the house for about $450,000 five years earlier, he says.

A big culprit, he says, was a boosted assessment. In March of last year, his house was reassessed at $625,000, an increase he blames on an influx of newcomers who have heated up the local market. "People have been moving out here from Washington, D.C., to get away from the hustle and bustle and have been willing to pay $600,000 for a home," he fumes. "That has nothing to do with me."

Mr. Aitken has helped start a group called Virginians Over-Taxed on Residences, or VOTORS, that is pushing for a range of state measures that would cap property taxes, including a constitutional amendment that would reset property values to their January 2000 level.

Similar movements have taken off in other cities and states, putting pressure on politicians to stem the tide of increases and inspiring legislative measures and even a few taxpayer proposals that may be on ballots this November.

They are the latest in a wave of modern tax revolts that began with the 1978 passage of Proposition 13 in California, which rolled back property taxes and limited the ability of municipalities to raise them. Even Californians, though, have seen big increases in recent years, since ***properties there can be reassessed when sold or transferred and there has been a flurry of such transactions. Property taxes "have grown very vigorously," says Marianne O'Malley, an analyst at the state's Legislative Analyst's Office in Sacramento, which provides nonpartisan fiscal and policy advice to the legislature***. {JM note: in CA, taxes owed don't rise from the actions of others (unlike Aitken in Virginia example cited above). Property tax payments rise only if you move. You can't be taxed out of your home in CA by a bidding war for homes in your neighborhood.}

Earlier this year, voters in Oregon recalled an $800 million tax boost, which included increases in property taxes, passed by the state legislature last August to plug a hole in the state's budget. Led by antitax activists, voters collected more than twice the number of signatures needed to force a recall referendum.

In Maine, where property taxes assessed rose an average of 7% in 2002 and another 5.51% in 2003, a group called the Maine Taxpayers Action Network, led by Carol Palesky, an accountant and grandmother in her mid-60s, is pushing to get an initiative for a 1% property-tax cap on the November ballot.

Meanwhile, state legislatures in Illinois and South Carolina, in response to ***citizen outrage over high taxes***, recently passed bills limiting increases in property-tax assessments. On

Monday, Illinois Gov. Rod Blagojevich signed ***legislation intended to slow the rate of increase in assessments***.

In Clark County, Nev., which includes Las Vegas, Tax Assessor M.W. Schofield has called on the state legislature to limit to 6% the maximum annual increase in assessed home values. ***Land prices are rising so fast in the county that, without a cap, property tax bills next year are likely to shoot up 20% to 50%***, depending on the neighborhood, says Michele Shafe, assistant director of the assessor's office.

"That's enough to put somebody out of their home, especially senior citizens," she says.

Texas-Sized Tax Revolt
April 4, 2006; Page A22

If Republican politicos are wondering how they can crawl back into the good graces of the electorate, they might want to study the primary results from last month deep in the heart of Texas.

In one high-profile GOP primary for a state senate seat in Houston, radio personality Dan Patrick sent shock waves through the political establishment by promising serious property tax relief. He won a 69% rout over three elected officials seeking higher office. Also on the primary ballot was an initiative asking voters whether they support a directive to all GOP officeholders to push a spending and tax limitation measure. It won with 89.9% of the Republican vote.

Across the country, the hottest money issue at the state and local level is property taxes. Tax collectors are reaping giant windfalls from the national housing boom, as the average property tax on an American home has climbed to just shy of $3,000 a year. The National Taxpayers Union reports that Texas is one of at least 20 states -- including Arizona, Idaho, New Hampshire, Nevada and South Carolina -- where homeowners are rebelling against soaring assessments that in some cases are taxing people out of their homes. The discontent is reminiscent of the anxiety that led to California's famous Proposition 13 property tax cut 27 years ago.

Texas is the epicenter of this backlash, because property tax bills in some localities have doubled in seven years, according to the taxpayer group Americans for Prosperity. But Republicans have had a devil of a time doing anything about it, thanks in part to court-ordered school funding disputes.

The Texas Supreme Court last year ordered the legislature to cut the state's school property tax -- which reaches as high as $1.50 for every $100 of value -- and come up with a new way to fund the state's public schools. So last week Republican Governor Rick Perry embraced a tax plan that cuts the property tax by one-third in many localities and eliminates the state's hated business franchise tax, which is a disguised business income tax on capital-intensive industries.

If Mr. Perry had quit there, he'd be the second most popular man in the state behind Longhorn quarterback Vince Young. Instead, he fell into the trap of proposing to "pay for" these cuts -- in this case with a new 1% business tax on gross receipts that will raise the tax liabilities of small businesses by an estimated $800 million, according to fiscal analysts in Austin.

His proposal also shifts the burden of paying for schools onto employers from local homeowners. Bad idea. That further severs the connection between those who pay for local schools and those who use them. And it is a proven formula for adding power to the education bureaucracy by eroding schools' responsiveness to the communities and parents they are supposed to serve. This is also dangerous politically. When then-Governor George W. Bush flirted with a similar "spread the pain" tax plan 10 years ago, he was nearly tarred and feathered by the state's small employers. He might never have made it to the White House if he hadn't abandoned the proposal.

In Texas, as in most other states, there's a better way to cut property taxes. The latest data indicate that overall state revenues rose 10% last year, and that the combined state surpluses could reach $25 billion this year. Rather than allowing these revenue surpluses to get spent, politicians could claim them to finance installment reductions in property taxes.

Texas already has a $4 billion surplus (expected to grow to $6 billion by year's end) and if that money were used to buy down property taxes, the rate could be cut by an estimated 25 cents per $100 valuation. If the politicians in Austin were then to adopt a tax limitation law capping taxes at population growth plus inflation -- which nine of 10 Republican voters in the state just said they favor -- another 20 cents could be trimmed from property tax assessments within two to five years.

Critics will claim that using surpluses to cut taxes is fiscally shortsighted because good times don't last forever. But returning surpluses to taxpayers is the only way to ensure that they don't get spent on new or expanded government programs that end up breaking the bank during the lean years. That was how many states went nearly belly-up in 2001-02.

Mr. Perry tells us that his goal is to make Texas "the top performing economy in the nation" and to "create a world-class tax system that is a magnet for businesses to come here from coast to coast." He's right that cutting the stampeding cost of property taxes will help accomplish that goal. But raising taxes on the very businesses that he's trying to attract surely won't.