



The Case for Surplus-Financed Business Tax Relief

By Byron Schlomach, Ph.D., Chief Economist

It looks like Texas will have a truly historic surplus by January of 2007 when the Legislature next meets. Guesses range from \$8 billion to an eye-popping, jaw-dropping \$15 billion. Common sense and sound accounting both tell us that a government with “money in the bank” over and above that needed to fund the current budget does, indeed, have a surplus.

A stark choice will confront Texas legislators in just two months. They can either spend this windfall of hardworking taxpayers’ money, or they can return the funds that taxpayers have been overcharged for the current level of spending.

Some say the surplus isn’t real because they would like to have it spent on other “needs” that they have identified. Excluding federal funds, Texas’ inflation-adjusted budgeted spending per person in fiscal year 2006 is just under the record high. In a growing and increasingly affluent economy, it is difficult to believe that needs are even greater now than they were when the standard of living was lower.

Others say we cannot use the surplus to reduce business taxes because it will obligate us to fund the tax cuts in future biennia, and the money is not likely to be there. They also point to the obligation the state has to reduce property taxes beginning in 2008. This first ignores the fact that Texas has had a surplus in every biennium for 15 years, except at the worst of the recession in 2003. In addition, history shows that if the funds are not used to finance tax cuts, they will be used for spending on new or expanded programs.

Whether for tax cuts or new spending, the current surplus will be used to create new obligations. One of these will keep the size of state government at just its current historical high. The other will grow state government to further, unprecedented levels.

Even with the low estimates of the surplus, the new business income tax could be largely eliminated. With a large state tax cut, further economic growth could lead to the revenues needed to entirely eliminate the business tax before we have to build the bureaucratic, accounting, and legal expertise to implement it.

A \$4 billion per year tax cut would boost the Texas economy, and help ensure that future revenues meet future spending priorities. Texas has one of the nation’s strongest economies for a reason—it has historically been a low-tax state. However, a weakness of Texas tax policy has been the investment-devastating level of business taxation. Texas is one of the highest direct business-taxing states in the nation.

Lowering the business tax burden and giving all Texans a \$4 billion tax cut would make Texas a beacon for business relocation and expansion. Considering that even without the new, higher business income tax, 5.8 percent of the gross state product is lost to state and local business taxes—the seventh-highest burden in the nation—Texas businesses need a tax cut every bit as much as Texas homeowners. Not using the current surplus for business tax relief would send exactly the wrong message.

With a surplus better than \$8 billion strong, the Legislature can make Texas the premier high-growth, low-tax economy in the United States. It should not fail to take advantage of this opportunity. ★

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