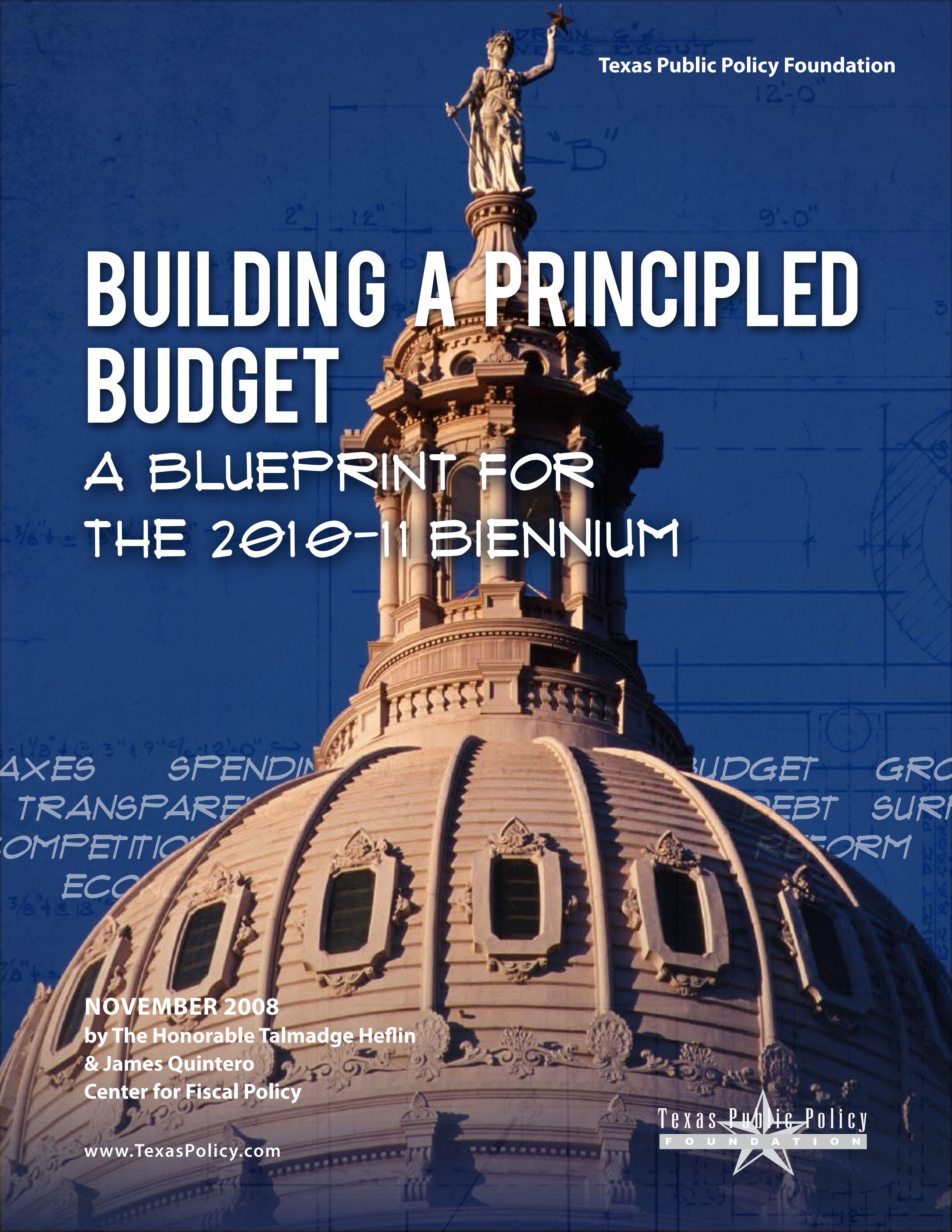
Texas Public Policy Foundation

BUILDING A PRINCIPLED BUDGET

A BLUEPRINT FOR THE 2010-11 BIENNIUM



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Center for Fiscal Policy

Texas Public Policy FOUNDATION

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Executive Summary

Texas is ranked as one of the nation's premier economies due, in part, to its relatively low tax, pro-business policies.[1] Here are just a few categories where Texas now leads as a result of its approach: "job creation, gross state product, low unemployment rate, and foreign direct investment."[2] When the 81st Texas Legislature convenes next year in mid-January, they will have the opportunity to preserve these successes by writing a responsible budget that promotes economic growth.

Budgets are about setting priorities. No matter whether for household or an entire state, a sensible budget helps prioritize spending and set reasonable limits. Insisting on this type of budget discipline is critical since the state is reported to have another sizable surplus and there will be tremendous pressure on the Legislature to spend this money rather than return some of it to taxpayers.

To maintain a principled approach to writing the next budget, Texas legislators should focus on these areas:

- First, limit spending increases. Even though Texas may have a surplus this biennium, it may not have a surplus next biennium. Obligating taxpayers to pay for more government today, when we have been blessed with an overflow, forces tomorrow's taxpayers to pay higher costs for government in the future when they may not be as fortunate.

- Second, focus on results. Programs and agencies can always spend more, but that doesn't mean they necessarily should. Tax dollars are a limited commodity and should be treated as such when legislators are comparing costs vs. results.

- Lastly, increase transparency. Financial transparency is an important part of good governance. It allows fiscal watchdogs to identify spending inefficiencies, boost taxpayer confidence, and promotes open government.

To evaluate the budget and protect taxpayers, legislators should also develop standard criteria to judge the worth of government programs and services. Answering such questions as "does the program advance the goals of Texas government?" or "does a program have a history of success?" will be an important part of controlling the unnecessary growth of government.

By strengthening Texas' Tax and Expenditure Limit (TEL), members of the 81st Legislature can address another important area that protects taxpayers from the uncontrolled budget growth. As it is now, Texas' TEL is critically flawed and leaves taxpayers with little more than superficial protections.

Once legislators have a finalized budget, any remaining surplus revenue should be returned to taxpayers via targeted tax relief. The sales tax offers legislators the cheapest, simplest way to do this since lowering the rate requires little government intervention and applies to the majority of Texas taxpayers.

Introduction

When the 81st Texas Legislature convenes at noon on January 13th, 2009, legislators will find themselves with a 3rd consecutive budget surplus. Although the surplus' exact size is somewhat uncertain, the Texas Comptroller of Public Accounts announced in May that the state would have an estimated $10.7 billion in surplus revenue.[3]

Of the projected $10.7 billion surplus, $3 billion will be set aside for the Property Tax Relief Fund and $5.7 billion is committed to the state's Rainy Day Fund, leaving roughly $2 billion at the discretion of lawmakers. Some will insist that $2 billion is not a lot of money by government's standards, but for those who pay the tab, $2 billion is quite a bit. Consider that if the $2 billion in surplus funds were somehow returned directly to every man, woman, and child in the state, 24.4 million Texans would have an extra $82 in their wallets.[4] Just think how much better off the state's economy would be if that money were circulating through the hands of those who earned it!

No matter how big the surplus turns out to be, Texas lawmakers will face a tough choice: spend this windfall to grow government further or return it back to taxpayers.

There are some who will argue that the surplus isn't real because government "needs" to spend it on expanding entitlement programs. But this claim ignores the limitations of taxpayer money. Like a dog chasing his tail, government will be forever trying to meet a new demand—demands that can never be fully met. This is because taxpayers only have a finite amount of money, whereas there are few limits on how much government can spend.

Others will contend that we should not use the surplus to reduce taxes because it will obligate us to fund those tax cuts in future biennia and the money is not likely to be there. They also point to the obligation of the state's Property Tax Relief Fund. This first ignores the fact that Texas has had a surplus in every biennium for 17 years, except at the worst of the economic downturn in 2003. Furthermore, history shows that if the funds are not used to finance tax cuts, they will be used for spending on new or expanded programs. But the fundamental problem with this argument is the idea that tax cuts are paid for by the government with government money. This simply isn't the case. The truth is that tax cuts are simply a return to taxpayers of their own money and—especially when surpluses exist—an acknowledgement by policymakers that government collected too much money in the first place.

No doubt, these and countless other arguments will be made in defense of big government and the welfare state; but, ultimately, these assertions do not hold. ***Government does not create prosperity; it is a barrier to it.*** Taxes are a drain on an economy; government borrowing and spending indebts present and future taxpayers; and bloated government often invites fraud, waste, and abuse.

The perils of uncontrolled government growth are many and the Legislature needs a bold, decisive approach to avoid wasteful spending—particularly since surplus revenue is once again available. If lawmakers are successful in guarding taxpayers, they will preserve Texas' relatively small state and local tax burden that ranks 43rd nationally;[5] a per capita state and local spending figure that ranked 42nd in 2006;[6] and a state economy which time-and-again is the envy of the nation:

- A survey by Development Counsellors International (DCI)—an economic development and tourism marketing firm—recognized "Texas as having the most favorable business climate"[7] in the nation for a fourth consecutive time;

- *CNBC* ranked Texas as "America's Top State for Business;"[8]

- Texas is home to more Fortune 500 companies than any other state—58 to be exact.[9]

Texas is blessed with an innovative economy, an entrepreneurial spirit, and an industrious attitude that has, until now, unlocked tremendous economic prosperity. But we are at a crossroads. We can either follow the road of Congress and many other states by spending our surplus and turning it into future deficits, or we can continue down the path of fiscal responsibility. Texas learned a valuable lesson in 2003 when the Legislature balanced the budget with a $10 billion shortfall without raising taxes; the challenge now is to demonstrate that we have not forgotten it.

Many states are suffering through significant economic downturns. Thirty states were in a recession during September 2008 and many more were "at risk," according to a recent report by Moody's.com.[10] Yet, Texas' economy remains strong:

- **Jobs are being created:** "In the 12 months ending in September 2008, Texas gained almost 248,000 jobs, more than the next 14 top job-growth states combined."[11]

- **Wealth is being generated:** *The Financial Times of London* recently reported that Texas' personal income grew 5.8 percent annually from 2007 to 2009—more than any other state.[12]

- **People are coming to the state in droves:** From 2000 to 2007, "Texas' population grew at more than double the national rate—14.6 percent versus 7.2 percent, according to the U.S. Census Bureau. Five of the 10 U.S. counties registering the highest numerical population growth between 2006 and 2007 are in Texas, as are 11 of the top 25 counties."[13]

How has the Texas economy positioned itself so well when most other state economies are floundering?

Unlike many other states, Texas has done a relatively good job of keeping government out of the economy. That's not to say there aren't areas where Texas can improve—there most certainly are—but, comparatively, the state has been quick to adopt substantive, free-market reforms. Case in point: Texas' energy deregulation that has led to a reliable and affordable supply of electricity to meet the state's growing needs;* the state's elimination of the Telecommunications Infrastructure Fund (TIF);† and Texas' leadership role in the area of incentive pay for teachers.‡

Sound Budgeting Principles

As legislators enter into the next session, there will be many more opportunities for them to strengthen our economy through free market reforms and pro-growth policies that have done so well for us in the past. One of the biggest, and most immediate, opportunities will present itself when lawmakers begin crafting the budget.

Creating a Texas-sized budget is no easy task; it's an ambitious, complex political ballet that lasts only 140 days. Needless to say, legislators can become overwhelmed, but by approaching the budget process with a clear mindset and firm principles, a good final product can be the result. Proposed here are three recommendations that will help legislators to craft a budget that promotes economic growth and protects taxpayers.

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*For more information, *see* "Affordable & Reliable Energy: An Energy Policy For Texas," http://www.texaspolicy.com/pdf/2008-Energy-LegeEntry-khw-bp.pdf.

† For more information, *see* "Temporary TIF Tax Must Go," http://www.texaspolicy.com/commentaries_single.php?report_id=1461.

‡ For more information, *see* "Paying for Results: Examining Incentive Pay in Texas Schools," http://www.texaspolicy.com/pdf/2008-09-RR09-IncentivePay-bt.pdf.

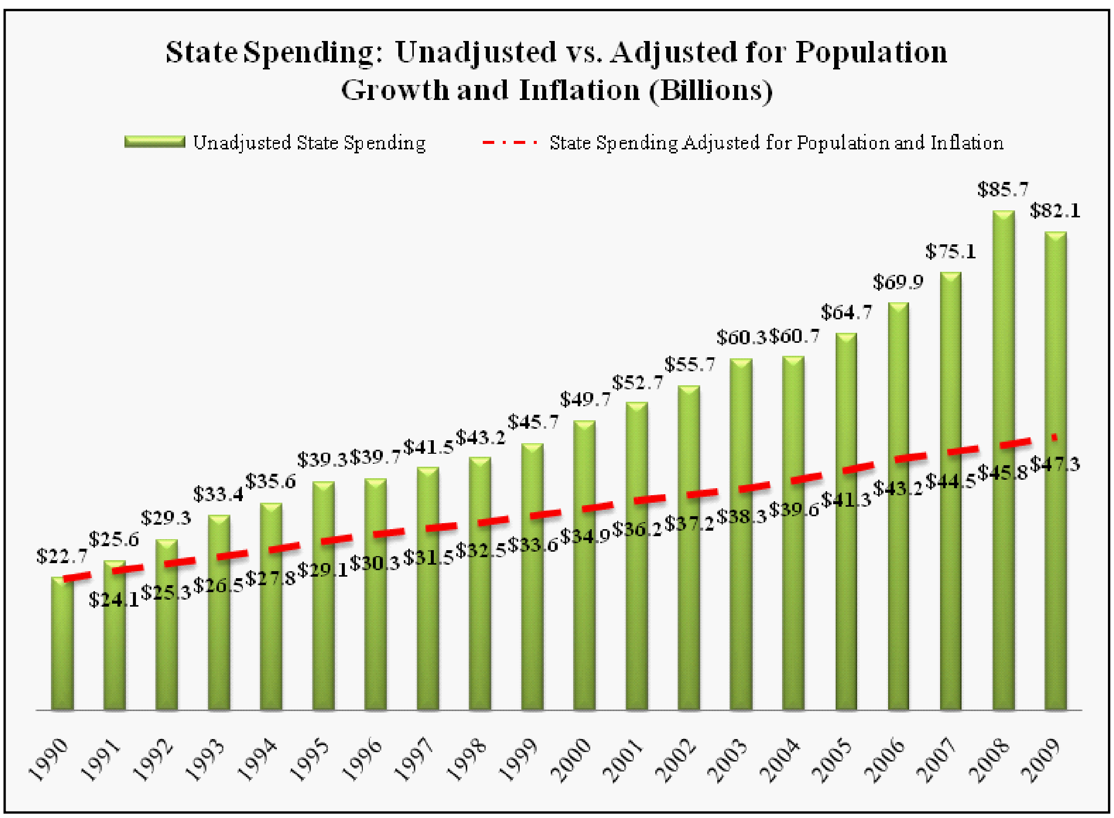
Since 1990, state government spending has climbed from $22.7 billion to $82.1 billion—an increase of 261.7 percent; yet the growth in population and inflation only increased 108.4 percent over the same period.

Recommendation 1: Limit Spending Increases

One of the great accomplishments of the 80th Legislature was that lawmakers left $7 billion of surplus revenue unspent while simultaneously providing homeowners and businesses with much needed tax relief. By their actions, the Legislature freed Texans from paying for any major, new obligations and, as a consequence, left more money in the wallets of taxpayers to spur on the economy.

Despite the 80th Legislature's commendable display of fiscal discipline, the figure below shows that state spending has grown at levels well-above the rate of population plus inflation in recent years.

Since 1990, state government spending has climbed from $22.7 billion to $82.1 billion—an increase of 261.7 percent; yet the growth in population and inflation only increased 108.4 percent over the same period. If state spending had been limited to the



State Spending: Unadjusted vs. Adjusted for Population Growth and Inflation (Billions)

Controlling the growth of state spending is one of the most important challenges facing the incoming Legislature and it will have a big impact on the outlook of Texas' future economy.

growth of population and inflation from fiscal years 1990 to 2009, Texas taxpayers would have had an additional $320.9 billion in their wallets.

Controlling the growth of state spending is one of the most important challenges facing the incoming Legislature and it will have a big impact on the outlook of Texas' future economy.

Make no mistake about it: increased government spending negatively impacts a state's economy. In the Foundation's recent report, *Competitive States: Texas v. California*, Dr. Arthur Laffer* explains:

> "First, in order for the government to have revenue to spend, it must take this money away from the private sector. As governments get larger and larger, the value of the dollar taken away from the private sector is greater if it were spent in the private sector than the value of the money if it were being spent by the government. As a consequence, the government spending lowers the total potential output in the state. Second, larger government spending today oftentimes begets even greater government spending and activity tomorrow. In other words, the threat of higher tax and regulatory burdens grows as the size of government grows."[14]

Thus, according to Dr. Laffer, the growth of government spending adversely affects a state economy in two ways.

First, government has no money of its own, so it must either tax or borrow—i.e., future taxes—to spend any amount of money. Here rests the fundamental but generally ignored truth that supports the principle of limiting future spending increases: increased government spending today reduces economic growth tomorrow. Because of the additional costs incurred by the government's taxing and spending efforts, and because the government redirects financial resources away from the priorities of families and businesses, the value of the goods and services government provides is less valuable than the money it collects.

Second, higher spending today obligates more government spending—and higher taxes—in the future. As a result, taxpayers are not only stuck with a higher tax bill today, but they also reduce economic growth tomorrow.

Minimizing the economic burden of increased government spending must be priority number one for the 81st Legislature. To do so, the Legislature must be vigilant in its use of tax dollars, particularly when determining whether a program or agency is costing taxpayers more than it should.

Recommendation 2: Focus on Results

Deciding whether a program or agency has outlived its purpose is always a challenge for legislators. Determining the value of a program or agency is not as easy as it seems.

*Dr. Arthur B. Laffer is the founder and chairman of Laffer Associates, an economic research and consulting firm that provides global investment-research services to institutional asset managers, pension funds, financial institutions, and corporations. Since its inception in 1979, the firm's research has focused on the interconnecting macroeconomic, political, and demographic changes affecting global financial markets.

Weeding out wasteful government spending using outcome-based performance measures is one method to rein in the growth of government.

Too often a program's success is judged by the wrong measure; that is, government's success is often judged by how much money it spends or how paperwork is processed. But just because you can spend money doesn't mean you should, and simply because an agency can produce a particular good or service doesn't mean it has any value. So how do legislators separate the good programs from the bad ones?

Ideally, government's value should be determined by measurable results. These can take the form of performance measures, but not all performance measurements are created equally. Texas' budget is a good example; even though the budget is considered "performance-based", many of the performance measures refer to output* measures. Legislators should instead focus on outcomes—the actual results of a program or agency—to help guide them through the appropriations process.

For example, a road agency can measure how many lane miles it constructs or it can measure the mobility of the population and how its road construction and maintenance affects that mobility. The former measures activity. The latter measures results.

Weeding out wasteful government spending using outcome-based performance measures is one method to rein in the growth of government. Another method growing in popularity is transparency.

Recommendation 3: Increase Transparency

Under the guidance of Governor Rick Perry, Comptroller Susan Combs, State Representative Mark Strama, and the legislators of the 80th Session, Texas has assumed a leadership role in government transparency. Far from being just a buzz word, transparency has transformed the way state agencies operate, helped to educate taxpayers and empower fiscal watchdogs, and given a sense of renewed confidence to the public.

Perhaps one of transparency's greatest achievements is its ability to shield taxpayers against over paying for government. In August 2007, as a result of House Bill 3430 by Representative Strama, Comptroller Combs launched a comprehensive state spending website, "Where the Money Goes," at a cost of $310,000. To date, taxpayers have saved a grand total of $8.7 million with $2.3 million saved in the first year alone. These savings were realized by consolidating contracts, eliminating several duplicative services, and removing some outdated "needs," like pagers.

And yet, transparency is still in its infancy in many ways. For example: 1) the number of local governments (local spending constitutes roughly 55 percent of spending in Texas government) to adopt online transparency measures is only a fraction of what it should be; 2) transparency at the state level is complicated by the fact that cross-referencing agency ex-

* Output measure—the answer to the question, "what is the product, service, or result of this activity?"

According to the U.S. Census Bureau, local governments spent $40.3 billion in 1991; by 2006—the latest year data is available—local government spending had risen by 138 percent to $95.5 billion.

penses is near impossible because agencies report expenditures in different ways; and 3) a number of items—public payrolls, government contracts, and some government payments to businesses and individuals—are still hidden from taxpayers.

In the upcoming session, legislators can address many of these gaps. Here are some of the areas where legislative support would be helpful:

- **"Single Set of Books":** Despite the success of the state's online spending database, users are still limited in their ability to make agency-to-agency comparisons because of a lack of uniformity in how agencies collect and report expenditures.

  To remedy this, the 80th Texas Legislature, per HB 3106 by Representative Carl Isett, created the Enterprise Resource Planning Advisory Council. The council, chaired by the comptroller and composed of representatives from several state agencies, has been charged with developing a plan to create "a common database and common software tools that allow real-time information across organizations, agencies, divisions, or departments to be easily shared, compared, and immediately available."[15]

  Now that a plan has been developed*—and will be soon submitted for review—the Legislature has an option to adopt this "single set of books" initiative—or a similar initiative—to bring Texas government more fully into the era of "Google Government."

- **Local government check registers:** Local governments have been very slow to adopt online transparency measures to show where large increases in government spending are going. According to the U.S. Census Bureau, local governments spent $40.3 billion in 1991; by 2006—the latest year data is available—local government spending had risen by 138 percent to $95.5 billion.[16] This growth in spending happened despite population and inflation increasing only by 82 percent.

  To illustrate the lack of transparency at the local level, consider that only two of Texas' 254 counties have their check registers online,† less than 300 of Texas' 1,031 school districts post their check registers online, and three of Texas' largest cities—San Antonio, Austin, and Dallas—do not have their check registers online.

  The time has come for the Legislature to mandate that every local government—school districts, in particular—post their check register online in an easy-to-find, user-friendly format. Taxpayers are entitled to this information.

- **State contracts:** The lack of transparency over the awarding of contracts invites distrust. One of the ways to make state contracts more transparent is to provide online access to the text of all winning and losing bids. The reason for this is twofold. First, making the text available to the public is the surest way to combat favoritism in the system since officials know that they may have

* To view a draft of this report, *see* http://www.texaserp.org/advisory/pdf/ERP_Advisory_Council_Report.pdf.
† At the time of this publication, only Collin and Smith Counties had their check registers posted online.

As the state's most precious resource, hard-working taxpayers are counting on the efforts of the 81st Legislature to deliver real protection from the growth of government.

to justify their decisions to taxpayers. Second, the competition for state contracts is fierce. By posting the contracts online, bidders can get a better idea of what the state looks for when it selects a winning bid.

Writing a state budget is a significant responsibility and legislators can improve the overall quality of the final product by: limiting spending, focusing on results, and improving transparency. As the state's most precious resource, hard-working taxpayers are counting on the efforts of the 81st Legislature to deliver real protection from a declining national economy and the growth of government.

Criteria for a Responsible 2010-11 State Budget

With only 140 days to conduct their legislative affairs, lawmakers have an obligation to conduct a thorough review of every state expense. To do this, they must carefully and deliberately consider each budget item and determine whether it might be better used in other more pressing areas, or returned back to the economy and taxpayers.

The principles already outlined in this paper can help the Legislature develop clear and understandable criteria to objectively evaluate the use of tax dollars. The following are five questions designed to help the Legislature apply those criteria to the 2010-11 budget. Answering no to any of these questions should cause policymakers to closely examine the suitability of the government program to receive taxpayer funds.

Does the program advance the goals of Texas government?

Advancing the goals of Texas government is the first, and most important, responsibility of a government agency or program. Government activities, left to their own devices, serve no useful taxpayer function. But what are the goals of Texas government? The Texas governor provides one possible answer.

At the start of each budget cycle, the governor, in cooperation with the Legislative Budget Board (LBB), issues a statewide mission statement. The purpose of the governor's mission statement is to propose a vision for the state's future. Agencies use this mission statement to develop a framework to begin developing their budgets and programs. Earlier this year, Texas Governor Rick Perry issued his mission statement:

> "Texas State Government must be limited, efficient, and completely accountable. It should foster opportunity and economic prosperity, focus on critical priorities, and support the creation of strong family environments for our children. The stewards of the public trust must be men and women who administer state government in a fair, just, and responsible manner. To honor the public trust, state officials must seek new and innovative ways to meet state government priorities in a fiscally responsible manner."[17]

Although broad, the governor's mission statement establishes boundaries and sets the agenda for state agencies. Government activities that subvert this purpose serve no real purpose and should be dis-

continued immediately. Taxpayers can ill afford the arbitrary growth of government.

Does the program clearly benefit the general public?

Since taxpayers have little, if any, choice on paying taxes, government has a responsibility to ensure that those funds are used in a way that clearly benefits the general public. When tax dollars are used to inappropriately benefit a portion of the population at the expense of another, government creates an artificial system of winners and losers.

Taxpayers should be able to readily identify the benefits received from government goods and services. Programs that fail to meet that basic criterion should, at least, provide benefits that are very large and obvious. For example, law enforcement is a critical component of modern society that benefits all Texans. On the other hand, a government subsidized windmill museum in north Texas is a taxpayer waste and benefits only a small portion of the population at the expense of every taxpayer in the state.*

Are the benefits of a program worth more than the cost?

Taxes and other wealth re-distribution mechanisms are a drain on the economy. Any transfer of wealth from the private sector takes money out of the hands of those who've earned it and re-distributes it to whomever government has deemed worthy. As government continues to grow, the more resources it demands from producers and, consequently, the greater disincentive within the economy for productive activities. Thus, it is with great caution that policymakers should expand or create government programs without first weighing the costs and benefits.

The cost of government, however, cannot always be measured in dollars. Oftentimes, taxpayers forfeit opportunities and liberties even as they hand over their hard-earned tax dollars to fund government. Presumably, those funds could have been spent on goods or services that the taxpayer would have derived a direct benefit from. Therefore, the true cost of government is not just a monetary loss, but also an opportunity loss.

Henry Hazlett points out that measuring the benefits and costs of a particular government program is a challenge that often takes the form of art rather than science. "The art of economics consists in looking not merely at the immediate but at the longer effects of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups."[18]

Rather than undertake this effort, says Hazlett, most policymakers look "only at the immediate consequences of an act or proposal," or look "at the consequences only for a particular group to the neglect of other groups."[19]

In large part, this happens because it is much easier to look at the effects of a program in the short-term on one group. But the long-term and widespread harm that comes from such an approach makes it incumbent upon policymakers to put in the time and effort to examine the broader consequences of any

* For more information, *see* "Texas-Size Transparency," http://www.texaspolicy.com/pdf/2008-Veritas-Issue3_proof.pdf.

Some government programs may lack the ability to effectively measure their success. These programs should be eliminated; taxpayers deserve to know that their tax dollars are not being wasted frivolously.

policy, and perhaps even drop the idea if that analysis is not made.

Is the program intruding in an area where the free-market is working?

Too often government programs are borne out of lobbying efforts by special interests. While market failure is often cited as the need for intervention, the main reason behind many programs is that the special interests just don't like the decisions people are making in the marketplace. In addition, these programs often take on a life of their own and grow well beyond their original intent or even outlive the reason they were created in the first place. When this happens, the growth of government threatens the economy by removing incentives for the free market to innovate and deliver services cheaper, faster, and more effectively.

When government monopolizes an area where the free-market is working, the private sector cannot create more jobs, provide higher wages, or make investments, and society as a whole suffers.

This is not to say there is no role for government in the free-market system. Government plays a vital role in the creation of laws and boundaries within which the free-market can operate. It is when government steps outside the role of "referee" that it begins to encroach on the private sector and reduce economic growth.

Does a program have a history of success?

Texas government already uses performance based measurements to measure the success of a state agency or program, but not all performance measures are equally important. Policymakers should, instead, focus their time and attention on performance measurements that stress outcomes—the actual measurable results of a program or agency. In this way, policymakers can connect a program's past success with the appropriations it received and determine the true value of the goods and services it provides.

Some government programs may lack the ability to effectively measure their success. These programs should be eliminated; taxpayers deserve to know that their tax dollars are not being wasted frivolously.

Using the set of criteria mentioned above, legislators have the tools to thoughtfully question the legitimacy and value of each budget item. While it may be easy to pass a state budget for the sake of having a budget, taxpayers will be done a tremendous disservice without a careful and thorough review of how funds are being spent.

Strengthening the Texas TEL

There's an old cliché: "Government doesn't have a revenue problem, it has a spending problem." This is true in Texas as well. When the 81st Legislature convenes in January, they'll have an opportunity to address this age-old issue once more.

In 1978, Texas' constitutional Tax and Expenditure Limit (TEL) passed by an overwhelming majority of voters seeking much-needed tax relief. Unfortunately, Texas' TEL has proven to be ineffective at controlling the growth of government as originally intend-

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ed and has provided taxpayers with little more than a façade of protection against higher spending.

Article 8, Section 22 of the Texas constitution specifies that "the rate of growth of appropriations from state revenues not dedicated by this constitution" is restricted to "the rate of growth of the state's economy."[20] The vague wording of this clause creates many loopholes.

Since the spending limit only restricts the growth of non-dedicated tax revenue, it allows the growth of other revenue sources to go unchecked. This renders the spending limit highly ineffective.

Texas' TEL is also limited by the measurement it uses to calculate future growth—personal income. The measure works like this: by dividing next year's projected total personal income by this year's estimated total personal income, the Legislative Budget Board (LBB) determines how the maximum amount the Legislature can spend. The problem is that personal income is a poor representation of how prosperous a group is because it can be skewed by a relatively small number of affluent individuals. For example, let's assume a group of 3rd grade students all had $5 in their pockets and that was all the money they had. It would be fair to say that the group had a median personal income of $5. But what happens to the median personal income if suddenly Bill Gates joins the class? That figure skyrockets, but not because the group had any more money, only because an outlier skewed the distribution. Although this example is simplistic, it still illustrates how total personal income can rise, not necessarily because a population is richer. So when government bases its tax rates on personal income and increases spending, there's a good chance many in the population are overburdened by this. A more representative alternative to measuring the need for government services is the sum of population and inflation growth.

Another major flaw in the TEL is that a bare majority of the Texas Legislature can override the appropriations limit anytime legislators feel there is an "emergency." Emergency is never defined, and political will is all that stands in the way of spending increases.

Finally, the TEL lacks any provisions to allow lawmakers to look retroactively at the accuracy of the adopted growth rate. Without such a provision, lawmakers are hard-pressed to judge the accuracy of their estimations and make adjustments when the rate adopted was higher than actual growth.

Given all the weaknesses of Texas' TEL, it would be fair to say that the comptroller's revenue estimate has done more to control government spending than the constitutional spending limit. But the 81st Legislature has the power to fix the TEL and deliver meaningful taxpayer protection by amending some of the provisions.

The Seven Characteristics of a Strong TEL

Texas' spending limit has done little to control the growth of government in its 30 years of existence. Consider that 1990 to 2008, state spending nearly tripled—growing by nearly 280 percent. To be fair, the state's population has also increased, thereby increasing demand for state services, and inflation has caused costs for everyone to increase.

From 1990 to 2008, actual appropriations grew from $22.7 billion to $85.7 billion. However, if the state would have limited its expenditures to only population growth plus inflation growth, state spending would have only increased from $22.7 billion to $45.8 billion.

But even considering the growth in the state's population and inflation—the preferred measure to control government spending—government spending has surged. From 1990 to 2008, actual appropriations grew from $22.7 billion to $85.7 billion. However, if the state would have limited its expenditures to only population growth plus inflation growth, state spending would have only increased from $22.7 billion to $45.8 billion. That means taxpayers could have kept an additional $40 billion in their pockets in 2008 alone had state spending been closely controlled—a perfect example of the power and need for a strong spending limit.

To strengthen Texas' TEL, legislators must first understand what constitutes a strong spending limit. Here are seven recommendations:

- First, a strong TEL is self-contained in the state's constitution. There is no need, in other words, for enabling legislation. While this adds length to an already lengthy constitution in Texas, it is nonetheless necessary in order to prevent the Legislature from changing the fundamentals of the limit through a simple majority vote—all that is necessary in order to change a statute. While legislators can be called to account politically for such an action when it disadvantages taxpayers, the voting booth is generally a very indirect and uncertain sanction.

- Second, a strong TEL applies to all spending except, perhaps, that funded from federal grants. An advantage to including federal funding under a TEL would be the decreased likelihood that federal policy would dictate state policy. State spending might be less likely to migrate to federal priorities that require a state funding match if appropriations based on federal funding are also limited. Budget writers might otherwise be tempted to pursue unlimited federal funding with what limited state funding they have at their disposal, inviting costly tax increases. On the other hand, there is an argument not to include federal funding. The state legislature does not have complete control over its availability.

  With dedicated funds such as fuel taxes for roads and the lottery for education included under the expenditure limit it might be argued that these expenditures could crowd out other kinds of spending. For example, if fuel tax revenues rise quickly, this fact alone could force a higher priority on road construction and even reduce needed spending in other areas. This would occur because a total expenditure limit is finite and road expenditures would necessarily constitute a higher proportion of that finite limit since fuel taxes are dedicated.

  The reality, in contrast, is that there is little evidence that dedicated sources of revenue have risen faster, on average, than others. Another reality is that dedicated sources of revenue, especially those dedicated to education, generally fund a small proportion of the total spending for the purpose to which they are dedicated.

- Third, a strong TEL has a more stringent growth rate calculation than one based on personal income growth. Most states base their TELs' growth rates on personal income growth. Colorado,

> A limit based on personal income allows government to grow at least as fast as the economy.

once considered the best TEL in its Taxpayer Bill of Rights (TABOR), bases its growth limit on the sum of inflation and population growth. Personal income is a relatively expansive growth limit in the United States because its growth reflects a rising standard of living. Total personal income, on average, is rising faster than inflation and population growth alone would cause it to rise. A limit based on personal income allows government to grow at least as fast as the economy.

Population growth and inflation together are, indeed, relatively restrictive. As population grows it would be expected that government would have to grow with it to some extent. More roads, schools, prisons, law enforcement officers, and administrative personnel, among other things, are needed to take care of more people. Inflation does not just increase costs for the population at large, but costs for everyone are driven upward, including costs for government. A growth limit equal to the sum of population growth and inflation would not allow government to grow even at the same rate as the economy. Indeed, held to this growth standard, government would shrink relative to the economy.

What constitutes the "correct" growth rate peg depends heavily on one's philosophical and practical point of view with respect to the proper role of government. Many do not like the idea of government's growth being restricted at all. They see little wrong with government growing relative to the economy and would like to see it grow further and faster. Their view of government's proper role is an expansive one that envisions government providing a number of goods and services that have traditionally remained in the private realm.

Others see any growth rate that allows government to maintain its current size relative to the economy as allowing government to continue at a size that is already unhealthy. While few would argue that government should disappear altogether, there is an argument to be made that we can certainly afford to have it shrink relative to the economy. This point of view sees government in a support role. As technology improves and standards of living rise so that individuals are increasingly able to provide for themselves, less government is needed. In fact, it is entirely possible for government to grow in absolute size but not as fast as a growing economy and still have the right amount of government for a healthy society.

- Fourth, a strong TEL requires voter approval for growth in appropriations to exceed the limit. In Texas, only a bare majority of the Legislature is required for an emergency to be declared and the growth limit exceeded. Minimally, there should be at least a two-thirds vote requirement in the Legislature. Preferably, there would be a general election.

- Fifth, a strong TEL encompasses all levels of government within a state, safeguarding against transfers of unfunded mandates. That is, all levels of government would be limited in their growth to inflation plus the growth rate of their constituent populations. This would help prevent

A strong TEL requires excess funds to be disbursed to taxpayers and into a special reserve account in order to make up for shortfalls that will inevitably occur in some years.

circumvention of the TEL by "passing the buck" from the state level to local levels through the transfer of responsibilities. Also, by writing the law to adjust to the transfer of responsibility, a TEL would not prevent local tax relief funded by state surpluses.

- Sixth, a strong TEL requires excess funds to be disbursed to taxpayers and into a special reserve account in order to make up for shortfalls that will inevitably occur in some years. The reserve account helps prevent a "ratchet down" effect on state spending. Other excess funds would, ideally, be rebated to taxpayers. Tax rebates present a special problem for Texas since there is no state tax system that collects information about individual Texas taxpayers. In Texas, a method for generally reducing taxes as a way to return money to taxpayers would have to be devised and will be discussed in the next section.

- Seventh, a strong TEL includes spending adjustments according to actual growth rates, so that over the long term expenditures would grow at about the same rate as the growth rate limit. As was noted above, it is currently possible for growth in the expenditures currently under the Texas expenditure limit to bear little resemblance to the growth limit—that of personal income. Obviously, it would still be necessary to prognosticate growth rates for the sake of budgeting, but there should be some historical check, with teeth, that requires expenditure growth to comport with actual growth in the pegged variable or variables over time.

With these recommendations in hand, the Legislature can address the flaws and weaknesses of our own Texas TEL and provide an important piece of taxpayer protection. By effectively limiting the growth in state spending, taxpayers can expect a more responsible government that focuses on priorities over political whims.

Preferred Method for Returning the Surplus

Government is not a business. It doesn't earn money; instead, it acts more like a distribution center collecting money from productive activities to spend on less productive activities. Any "surplus" remaining at the end of year is money that was over-collected in the first place. As a matter of policy, returning these tax dollars should be a top priority for the upcoming session. But how?

Typically, there are two ways government can return surplus revenue to taxpayers. First, the state can issue a tax rebate, presumably in the form of a check, to all taxpayers based on the amount collected from each person. But such a rebate would be difficult, if not impossible, in Texas because the state does not have a state tax tracking system, such as an income tax, nor does it need one. Texas also lacks the infrastructure and personnel to mail out millions of tax refunds—doing so would require creating another bureaucracy which contradicts the spirit of returning the surplus in the first place. The alternative to the tax rebate system is to provide tax relief through reducing the rates of or eliminating existing taxes.

As the 12th largest economy in the world, Texas is an economic powerhouse. How long Texas remains in such great financial shape, however, depends on its commitment to keeping taxes low, restricting government growth, and maintaining a business-friendly environment.

Tax relief can come in many forms. One is targeted tax relief, such as a 1-year repeal of the Unemployment Insurance (UI) tax, the elimination of smaller taxes (e.g., the Telecommunication Infrastructure Fund)—but the simplest, cheapest, and most effective way to reach the greatest number of people is by lowering the rate of broad-based taxes.

There are several such taxes that might fit this criterion, notably the property tax, the margins tax, and the sales tax. While reducing the property tax should be a high priority for all Texans, the fact that the state doesn't levy the property tax means that it is not the most direct way to return surpluses to taxpayers. However, reducing the sales or margins tax rate would return surplus revenue directly to taxpayers, and has other advantages as well. First, it can be done at virtually no expense to taxpayers. There are no elaborate bureaucracies to staff and fund; no institutional barriers to overcome; the only thing needed is to re-calculate the rate based on the level of surplus. Since retailers act as faux government tax collectors, they would simply adjust the rate at the point of sale, and taxpayers would save.

A reduced sales tax rate will typically generate higher interest in consumer spending, which creates further economic activity. A lower state sales tax rate also could attract consumers from other surrounding states, thereby increasing Texas retailers' competitiveness. And a reduction in the margins tax would increase the profitability of Texas' businesses and increase their ability to provide jobs for Texans. So there are also economic benefits associated with reducing the rates of broad-based taxes.

Lowering the sales tax is only one surplus return mechanism, but it is the cheapest, most effective, and the simplest to implement. Returning the state's surplus back to taxpayers should be among the top priorities for the incoming Legislature.

Conclusion

As the 12th largest economy in the world, Texas is an economic powerhouse.[21] How long Texas remains in such great financial shape, however, depends on its commitment to keeping taxes low, restricting government growth, and maintaining a business-friendly environment. Texas legislators must remember this during the upcoming session and strive to avoid a repeat of the 2003 budget shortfall when the failure of big government spending was last evident.

Practicing fiscal discipline and guarding against wasteful spending will not be easy, particularly since Texas enjoys a projected $10.7 billion surplus, but restraining budget growth is a key to securing the Texas' future economic prosperity. To that end, legislators should focus on limiting spending increases, maximizing results, and improving transparency—especially with local governments.

When legislators have created a responsible budget, they have a responsibility to return the surplus back to those who've earned it—taxpayers. Although there are many tax relief mechanisms, the simplest and cheapest method of doing so is to reduce the sales tax rate. Texas' taxpayers will reap the benefits of such a system many times over. ✯

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