Texas Public Policy Foundation
Budget Solution$
Closing Texas' Budget Shortfall
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Economic Freedom, Texas Style

At the Texas Public Policy Foundation, we have been doing a lot of research recently on what we call "Economic Development: Texas Style." What we mean by this is that rather than rely on government payouts to businesses, government spending, or government programs to keep the economy growing, Texas tends to rely on economic freedom. There are several ways this shows up in the public policy choices made by policymakers in Austin.

One way is in lower government spending. Texas state government spent only $3,380 per capita in 2008, ranking dead last among the states, which means that Texas government spends much less as a percentage of the private economy than the U.S. or our largest competitor, California. The reason for this is that when the spending burden has begun to grow—usually during a recession, Texas policymakers have stepped up to the plate and brought it under control. This is quite obvious after the 2001 recession when in 2003 Texas met the challenge of balancing the state's budget without raising taxes. Because of this policy decision, Texas' 2008 spending burden remained slightly below its 1987 levels—a major accomplishment since our paper also shows a close negative correlation between government spending and economic growth: the less spending, the more growth.

But now, only eight years later, Texas faces the same challenge again. The spending burden has increased and Texas has a $15 billion budget shortfall. There are several reasons for this.

First, like all states, the Texas economy was hurt by the recession, resulting in lower state revenue of several billion dollars—we'll know for sure how much this is next week when the comptroller releases the revenue estimate. This impact will likely be felt in the current and next biennium, compounding the problem.

Second, though Texas is better off than most states, there have been spending decisions made in each of the past three legislative sessions that have increased the state spending burden and helped create the current 2011 budget shortfall:

- In 2005, there were several instances where savings from the 2003 legislative session were eliminated through renewed or increased funding;
- In 2007, the Legislature increased GR spending that biennium by 21.5 percent, 10.5 percent more than population growth plus inflation—which amounted to about $7.5 billion in overspending;
- In 2009, Texas used about $4.3 billion of federal funds to plug holes in the budget already showing weakness from the declining economy, pushing the problem from 2009 to 2011.

Finally, while the previous two points explain most of the budget shortfall—perhaps as much as $15 billion, Texas will also be facing pressure of increased spending based on federally-mandated Medicaid costs. Though in the past Texas has dealt with this problem through both increased spending and program changes, ObamaCare and the federal courts have virtually eliminated Texas' flexibility to contain these rising costs. This may add several billion dollars to Texas' budget problems.

If the current growth in the expenditure burden is curtailed by the Texas Legislature, it will bring Texas back to its long run trend of controlled government spending and keep us from heading down California's path toward overspending and economic weakness.

When we have controlled government spending, along with a requirement for a balanced budget, it follows that our taxes will be low as well. Indeed, that is the case here in Texas. And low taxes are the second way in which Texas fosters economic growth through economic freedom.

Texas ranks 43rd in state tax collections at $1,646 per capita. One reason for this is that we don't have a state income tax. Both of these facts are important. Over the last 10 years, the economies of states with the lowest tax burdens have grown by 88 percent, while those with the highest tax burden have grown only 58 percent. The same picture emerges for those states with no income tax versus those with the highest income tax rates; the economic growth is 86 percent versus 59 percent, respectively. ✯