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The Conservative Texas Budget

*This paper highlights The Conservative Texas Budget that recommends spending limits on the growth of state funds and all funds for the 2016-17 biennium**

by The Honorable Talmadge Heflin & Vance Ginn, Ph.D.

Key Points

- Texas may have a fund balance of $7.5 billion at the end of the current biennium.
- *The Conservative Texas Budget* recommends spending limits on state funds and all funds based on an estimated 6.5% increase in population growth plus inflation to help keep policymakers from spending all of the fund balance.
- The spending limits for the 2016-17 biennium are $142.2 billion in state funds and $215.2 billion in all funds.
- By recommending clear and achievable spending limits, *The Conservative Texas Budget* helps Texans restrain the growth of state government.

Introduction

Texas' economic vitality and robust job creation will likely generate a sizable fund balance (potential surplus) at the end of the current biennium.[1]

The Texas Comptroller of Public Accounts reported last year that there would likely be a $2.6 billion fund balance at the end of the 2014-15 biennium.[2] This estimate assumed state sales tax revenue growth in fiscal year (FY) 2014 of 3.5 percent.[3] However, faster economic growth and job creation have led to sales tax revenue growth at an annual rate of 5.4 percent.[4] Higher total tax collections and increased local school district property tax revenue could reduce state education spending obligations[5] leaving a $7.5 billion potential surplus by the end of this biennium.

SPENDING LIMITS FOR 2016-17 BUDGET

$142.2 BILLION *state funds*

$215.2 BILLION *all funds*

6.5% *(pop. + infl.)* *increase*

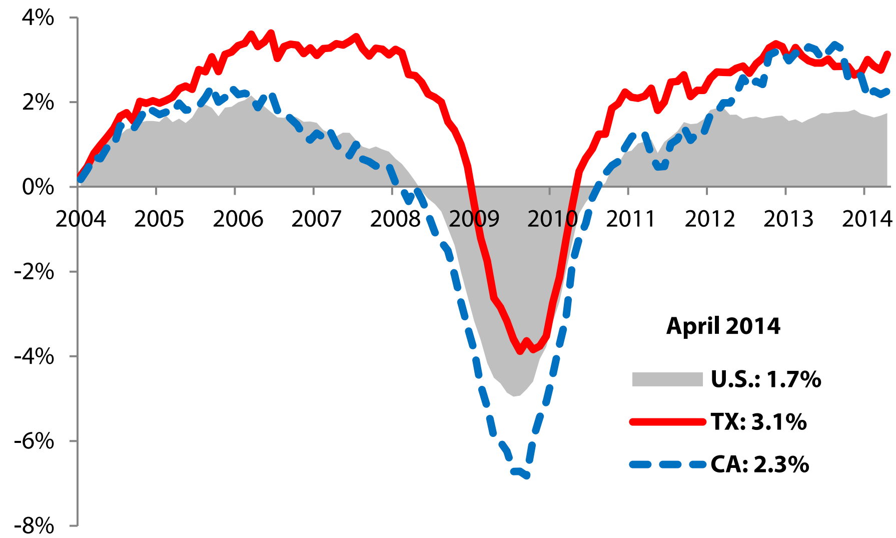
ABOVE 2014-15 SPENDING

During next year's regular session of the 84th Texas Legislature, lawmakers will approve a budget that will pay for all expenditures by state government during the 2016-17 biennium. With a $7.5 billion potential surplus, plus more tax revenue potentially coming in next biennium as the Texas economy continues to thrive, legislators may be tempted to spend every available dollar. They should avoid that temptation; unrestrained spending is not what has made Texas the nation's leading creator of jobs. In fact, the opposite is true.

continued

**This paper is an update to a December 2014 publication to include the latest Texas budget data.*

Figure 1: Faster Annual Job Growth in Texas



Source: U.S. Bureau of Labor Statistics

To help rein in the growth of all state spending, the Foundation has joined with its allies to propose *The Conservative Texas Budget*. Under *The Conservative Texas Budget*, spending growth of total funds in Texas during the 2016-17 biennium would be limited to population growth plus inflation. This paper explains how the Foundation calculates these limits, which use as a baseline the spending numbers in the Foundation's publication *The Real Texas Budget*.[6]

Spending Restraint Equals More Jobs

Annual job creation rates in Texas compared with its closest economic and demographic counterpart, California, and the U.S. average over the last decade (*Figure 1*), highlight the importance of spending restraint. Texas led the nation in job creation over much of this period. Rapid job creation in Texas has contributed to an equal or lower unemployment rate than the national average for 88 consecutive months and for 93 consecutive months compared with California through April 2014. This is noteworthy given that Texas has had a large increase in its labor force during those years from out-of-state migration compared to a declining labor force in many other states. Texas is now home to seven of America's top 15 fastest growing cities. Clearly, as fast as people are moving to Texas, job creation is keeping pace.

An important factor contributing to Texas' job creation success is the state's relatively low level of taxation, which includes no personal income tax, to support modest government spending. This success is found in other low-tax states as well. The Foundation's report *How Big Government Hurts the Economy* compares the nine states with a zero personal income tax rate to the nine states with the highest personal income tax rates (*Table 1, next page*), which include the top income tax rate state of California.[7] This comparison shows that states with lower income tax rates supporting modest government spending contribute to faster growth in those states' economy, job creation, population, and tax revenue.

This data provides valuable evidence that keeping tax rates low is important for Texas' success. To sustain the Texas economic miracle, it is imperative to keep tax rates low by limiting state spending growth.

Table 1: More Economic Prosperity in Low Tax States

Tax rates as of 1/1/2013, growth rates from 2001 to 2011 (unless otherwise noted)

State	Top Marginal Personal Income Tax Rate	Gross State Product	Nonfarm Payroll Employment	Population	State and Local Tax Revenue***
Alaska	0.00%	85.2%	13.2%	14.0%	166.8%
Florida	0.00%	48.9%	12.5%	16.5%	57.0%
Nevada	0.00%	64.9%	18.1%	29.8%	74.0%
New Hampshire	0.00%	42.2%	4.2%	5.0%	53.1%
South Dakota	0.00%	59.1%	12.4%	8.7%	48.9%
Tennessee	0.00%	45.1%	5.5%	11.3%	46.8%
Texas	0.00%	71.5%	20.5%	20.4%	65.6%
Washington	0.00%	54.2%	8.9%	14.1%	42.9%
Wyoming	0.00%	100.7%	18.9%	14.9%	131.3%
Nine Zero Personal Income Tax Rate States*	**0.00%**	**63.54%**	**12.68%**	**14.98%**	**76.26%**
50-State Average**	**5.69%**	**51.41%**	**7.62%**	**9.54%**	**49.79%**
Nine Highest Personal Income Tax Rate States*	**10.23%**	**45.90%**	**5.30%**	**6.50%**	**47.74%**
Kentucky	8.20%	41.6%	5.0%	7.4%	35.4%
Ohio	8.43%	26.5%	-2.5%	1.4%	26.8%
Maryland	8.95%	53.9%	9.5%	8.4%	53.5%
Vermont	8.95%	37.7%	4.5%	2.3%	57.5%
New Jersey	9.97%	33.4%	5.2%	3.9%	55.6%
Oregon	10.61%	73.1%	6.5%	11.6%	39.5%
Hawaii	11.00%	57.5%	10.2%	12.1%	60.9%
New York	12.70%	43.1%	7.2%	2.0%	56.8%
California	13.30%	46.2%	2.2%	9.3%	43.8%

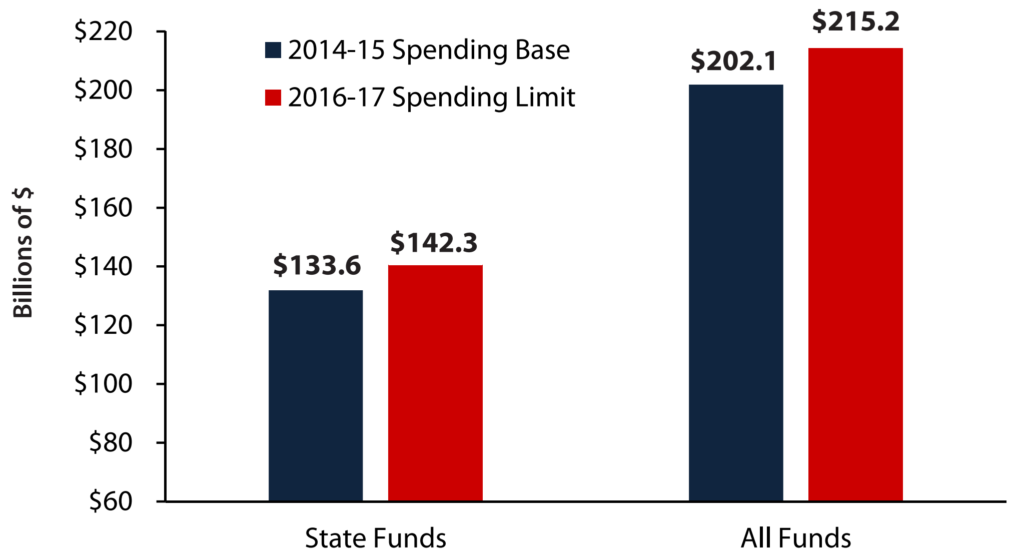
*equal-weighted average, NH and TN tax only "unearned" (dividend and interest) income only
**equal-weighted average, does not include D.C.
***2000-2010 due to data release tag

Source: How Big Government Hurts the Economy, Texas Public Policy Foundation (Nov. 2013)

While Texas has controlled spending relatively well compared with most other states, Texas' current limitations on government spending are not sufficient. The main challenge is the constitutional spending limit on general revenue funds not dedicated by the constitution.

Limiting growth of only a portion of state spending to an equal or lesser rate than the growth of the state's economy—a high limit, for which personal income is used as a proxy—can allow rapid growth in spending over time. In fact, even with this limit, state spending in Texas has increased by 62.5 percent since 2004. This increase is 12.2 percent greater than population growth plus inflation—costing Texans more than $11 billion, or a family of four more than $1,600, this year.

Figure 2: Texas' 2016-17 Conservative Spending Limits



Millions of $	2014-15 Base	2016-17 Limit	Change	% Increase
State Funds	$133,631.8	$142,317.90	$8,686.1	6.5%
All Funds	$202,083.3	$215,218.80	$13,135.4	6.5%

Source: Legislative Budget Board and authors' calculations

The Conservative Texas Budget

Reining in the excess growth in state spending requires that all expenditures be subject to spending limits. That is exactly what *The Conservative Texas Budget* does:

- Spending limits for the 2016-17 biennium are $142.3 billion in state funds, an increase of $8.7 billion over 2014-15 biennium spending, and $215.2 billion in all funds, an increase of $13.1 billion over current biennial spending *(Figure 2)*.

- The spending growth limit is based on actual population growth plus inflation data over the previous two fiscal years (2013-2014)—estimated to be 6.5 percent—because of the difficulty of forecasting future growth rates of economic variables in a dynamic economy.

- The estimates of how much the state will spend during the 2014-15 biennium including the latest 2015 bill supplement is from *The Real Texas Budget*: $133.6 billion in state funds and $202.1 billion in all funds.

- The recommended spending limits are placed on both state funds and all funds for the 2016-17 biennium to avoid possible manipulation of the budget based on the volatility of federal funding and shifting items from general revenue funds to other areas of the budget.

If the Legislature stays within these bounds in *The Conservative Texas Budget*, it will have taken a substantial step toward reining in the growth of Texas government.

These limits represent maximum amounts for the Legislature to use when determining the cumulative amount appropriated for each government agency. The Foundation believes that the Legislature could easily spend less than this and still ensure provision of basic public necessities. Nonetheless, if the Legislature stays within these bounds in *The Conservative Texas Budget*, it will have taken a substantial step towards reining in the growth of Texas government.

Calculation of the Spending Growth Limit

Population growth and inflation over FY 2013 and FY 2014 (i.e., September 1, 2012 to August 31, 2014) were calculated based on the following:

- **Population growth:** Using historical quarterly Texas population data obtained from the Legislative Budget Board (LBB) for the two fiscal years, we calculate a population growth rate of 3.1 percent.
- **Inflation:** Using historical quarterly consumer price index (CPI) data obtained from the LBB for the two fiscal years, we calculate an inflation rate of 3.4 percent.
- **Population growth plus inflation:** Adding population growth and inflation over this two-year period, we calculate a spending growth limit of 6.5 percent for the 2016-17 biennium.

Conclusion

The Conservative Texas Budget proposes spending limits for the 2016-17 biennium in state funds at $142.3 billion and in all funds at $215.2 billion.

These levels of spending will keep expenditures from growing faster than population growth and inflation—two key metrics that account for changes in the cost of providing basic public necessities. While *The Conservative Texas Budget* would allow sizable spending increases from the current biennium, the Legislature should find ways to further limit increases in government spending, leaving more money in the hands of hard-working Texans.

President Grover Cleveland provides wise advice for the Texas Legislature to follow when writing the budget next session when he said, "It is a plain dictate of honesty and good government that public expenditures should be limited by public necessity, and that this should be measured by the rules of strict economy."

The Conservative Texas Budget suggests clear and achievable spending limits for the 2016-17 biennium that legislators should follow to limit the size and scope of government and unleash individual liberty and economic prosperity for all Texans.

Endnotes

[1] *Texas to Remain a Top State for Job Growth in 2014,* Federal Reserve Bank of Dallas (First Quarter 2014).
[2] *The 2014-15 Certification Revenue Estimate,* Texas Comptroller of Public Accounts (Dec. 2013).
[3] Ibid, Table A-17.
[4] News Release, Texas Comptroller of Public Accounts (June 2014).
[5] Conversation with Paul Bettencourt, former Harris County Tax Assessor-Collector (Apr. 2014).
[6] *The Real Texas Budget,*Texas Public Policy Foundation (June 2014).
[7] *How Big Government Hurts the Economy,* Texas Public Policy Foundation (Nov. 2013).

About the Authors

The Honorable Talmadge Heflin is the Director of the Foundation's Center for Fiscal Policy. Prior to joining the Foundation, Heflin served the people of Harris County as a state representative for 11 terms. Well regarded as a legislative leader on budget and tax issues by Democratic and Republican speakers alike, he for several terms was the only House member to serve on both the Ways and Means and Appropriations committees. In the 78th Session, Heflin served as chairman of the House Committee on Appropriations. He navigated a $10 billion state budget shortfall through targeted spending cuts that allowed Texans to avoid a tax increase.

Vance Ginn, Ph.D., is an economist in the Center for Fiscal Policy at the Texas Public Policy Foundation. He is an expert on Texas' state budget, franchise tax, tax and expenditure limit, and other fiscal issues. In 2006, he graduated with honors from Texas Tech University with a B.B.A in economics and accounting and minors in political science and mathematics. After interning for a U.S. Texas Congressman in Washington, D.C., he started his doctoral degree in economics at Texas Tech University and graduated in 2013. Before joining the Foundation in September 2013, Ginn interned at the Foundation as a Charles G. Koch Summer Fellow in 2011 and then taught at three universities and one community college across Texas. He has successfully published peer-reviewed articles in academic journals, commentaries in multiple media outlets, and posts in free market blogs.

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