

Spend surplus? Legislature set to disregard cap

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As talk of a state budget surplus spread around the Capitol this week, lawmakers and special interests lined up in hopes of getting a piece of the toothsome pie served up by new Comptroller **Susan Combs**.

Surplus tops \$14 billion

In releasing her revenue estimate Jan. 8, Combs said the state will end the 2006-07 fiscal year with \$14.3 billion in new money, the “largest ending balance on record.”

Elected officials and policy makers reached across the table, hoping for big helpings.

“The Comptroller’s announcement of a historic budget surplus is welcome news that will help ensure Texas can fully fund property tax relief, and pay for priorities like border security and education,” Gov. **Rick Perry** said.

The Texas Medical Association called on lawmakers to use part of the surplus to increase reimbursement rates for Medicaid and the Children’s Health Insurance Program and to leverage more federal dollars to purchase private health insurance for the uninsured.

The liberal think tank Center for Public Policy Priorities (CPPP) denied that the surplus wasn’t really a surplus, rather money that would not exist had lawmakers fully funded current services.

On the other side of the spectrum, leaders of seven conservative groups, including the Texas Public Policy Foundation (TPPF), Americans for Prosperity Texas, and Texans for Fiscal Responsibility, have called on legislators to return a portion of the surplus – which they don’t doubt for a moment exists — to taxpayers.

“We write today with a simple, clear message: Return the certified surplus to Texas taxpayers,” said the group’s letter to lawmakers. “With \$14.3 billion in surplus revenues, and up to \$9 billion of which is in excess of those funds spoken for during the 2006 special session, the people of Texas deserve to have the money returned to them.”

The group would like the Legislature to reduce property taxes by an additional 30 cents, reduce the margins tax rate on businesses, and/or raise the threshold for businesses required to pay the tax.

Storm clouds ahead

While many groups may want to use the surplus to better fund existing programs or to pay for more tax cuts, Combs warned lawmakers that much of the \$14.3 billion surplus is already spoken for. “A lot of it is already allocated,” Combs said, “...so it’s not really free money.”

Over \$8 billion is already earmarked for the property tax cut. Other funds may go toward maintaining current services like education and Medicaid.

Combs warned that she expects a slowdown in the Texas economy, saying, "Our state's economy is producing vigorous revenue growth...However, it is my duty as Comptroller to point out that I do expect a cooling of the economy in the months ahead."

Combs pointed to three economic indicators: the cooling of the housing market, the stabilization of oil and gas prices, and reductions in consumer spending.

"Nationwide," she said, "the housing boom of the last two years is rapidly slowing. In Texas, new home starts that were up 20.7 percent a year ago were down 12.4 percent last October – a dramatic shift." She predicted that revenue from oil and gas will decline as prices drop from near-historic highs.

Another issue lawmakers may have to grapple with is whether or not the state will be able to pay beyond fiscal year 2009 for the property tax cuts passed in 2006. Last year, the Legislature passed a new margins tax on some businesses, but the revenue from that tax may not fully cover the property tax cut.

Combs' predecessor, former Comptroller **Carole Keeton Strayhorn** estimated last year that the state would be \$23 billion short of funds needed to pay for the property tax cuts over the next five years (2007-2011). The Perry campaign, however, questioned the gubernatorial candidate's accuracy of the numbers.

Combs, when asked if she thought the tax cut plan would put the Texas budget in the red over the next few years, said it was too early to say. The new margins tax is expected to generate \$11.93 billion over the next two years, of which \$6.1 billion is dedicated to the property tax relief fund. But even those numbers involve guesswork.

"I don't know," Combs said. "I have to take a look at the revenue coming in...Until June 2008, we're not really going to know where we are." That's when the checks will start coming in from the new margins tax.

With storm clouds on the horizon, Combs said she expects lawmakers will be prudent and cautious in formulating the state budget.

Lt. Gov. **David Dewhurst** has advocated saving a portion of the surplus to pay for the property tax cuts in future budget years. "My highest priority with the \$14.3 billion increase in general revenue," Dewhurst said, "is to provide the promised \$14 billion cut in local school property taxes for 2008-09, and save enough surplus to insure that these tax cuts can continue to be funded in the 2010-11 biennium and beyond."

The extent to which the Texas economy cools off remains to be seen. Only four years ago lawmakers faced a \$10 billion shortfall.

"This [\$14.3 billion surplus] really is not something you can expect to continue to go forward" in future budget cycles, Combs said.

Busting the spending cap

The Legislative Budget Board (LBB) voted Jan. 11 to set the rate of personal income growth at 13.11 percent, the lowest of the five estimates brought before the board. That means theoretically that lawmakers can increase non-dedicated government spending only by that amount.

Yet the Legislature is expected to exceed the constitutional spending cap by at least \$4 billion just to pay for \$14 billion in state spending over the next biennium for the property tax cuts.

Members of the Legislative Budget Board discussed measures to get around the constitutional cap. LBB director **John O'Brien** said the easiest way would be to pass an emergency resolution by majority vote to

allow appropriations tied to property tax relief to exceed the constitutional spending limits. Another option is to put a constitutional amendment before the voters to exempt tax cuts from the spending limit.

Many conservative organizations that would have denounced the Legislature for exceeding the cap due to increased government spending on programs, are actually supporting busting the cap to pay for tax cuts.

Some have argued that the \$14 billion price tag doesn't represent a net increase in overall government spending because state dollars will be replacing local dollars to buy down property taxes. Yet some conservatives who espouse less government are wary of voting to exceed the cap for any reason.

The more obvious option, albeit less palatable option, is to cut government spending in order to pay for the tax cuts and remain under the constitutional spending cap. Agencies would have to cut their budgets by 20 percent, O'Brien said.

"We cut the budget in 2003 and 2005. We cut 3,444 FTEs (full-time employees), combined four state agencies," Dewhurst said. "We're constantly looking for ways to save the taxpayers their money, but... cutting government 20 percent after we already made the cuts may be very difficult. But I'm sure we can... find some areas where we can reduce expenditures."