

Strengthening Texas' Tax and Expenditure Limit

by The Honorable
Talmadge Heflin
Director, Center for
Fiscal Policy

Katy Hawkins
Research Assistant

Recommendations

Improve Texas' TEL by:

- Making it self-contained within the state's constitution and does not require enabling legislation;
- Making it applicable to all state spending;
- Basing it on the sum of population growth plus inflation or the growth in personal income, whichever is less;
- Requiring a super majority vote of each chamber to exceed its limit rather than just a simple majority vote; and
- Expanding it in scope to include all levels of government within Texas.

Introduction

In the private sector, the profit-and-loss system serves as the primary mechanism through which performance and efficiency are determined.

If an enterprise is producing goods and services that consumers want, and does so in an efficient manner, then the entrepreneur is rewarded with profits. Conversely, if an enterprise fails to produce goods and services of value or operates wastefully, then the entrepreneur is penalized with losses, and if enough losses accumulate, he or she risks being driven out of the marketplace.

Under this system, the market incentivizes producers to satisfy the greatest amount of consumer demand, in the most efficient way possible, so as to receive the maximum potential benefit. The advantages of such a system are obvious.

In the public sector, by contrast, no such system exists to evaluate performance and efficiency. Instead, the success or failure of government programs hinges on more than just "consumer" demand; it is also a function of political and institutional considerations, which, all too often, have the effect of growing government regardless of market conditions or actual need.

For this reason, a pressing need exists for effective, practical limits on the revenues and expenditures of government.

Tax and Expenditure Limits: General Overview

One increasingly common method to restrain the public sector is by way of statute or constitutional provision, otherwise known as a Tax and Expenditures Limit (TEL).*

TELS work by limiting increases in government revenues, expenditures, appropriations, or some combination of the three to a fixed target, such as population, inflation, or personal income. The idea being that the growth of federal, state, or local government spending should be directly related to the community receiving those goods and services.

In general, all TELS seek to achieve the same goal—to put reasonable restraints on the growth of government—but some TELS are more capable of fulfilling this duty than others.

The difference has to do with the way a TEL is designed.

Weaker TELS are typically crafted to include vague legislative language, obscure measures, or provisions that allow a state legislature to easily override it. Stronger TELS, on the other hand, generally share most, if not all, of the following characteristics:

- Is self-contained within the state's constitution, not requiring enabling legislation;
- Applies to all spending, not just revenue derived from certain sources;

* According to the latest available data from the National Conference of State Legislatures, 30 states were operating "under a tax or expenditure limitation," as of December 2008.

- Bases the expenditure limit on the sum of population growth plus inflation or the growth in personal income, whichever is less;
- Requires voter approval for growth in appropriations to exceed the limit;
- Encompasses all levels of government within the state;
- When appropriate, requires the disbursement of surplus funds to taxpayers and/or into a special reserve account in order to make up for periodic shortfalls; and
- Includes spending adjustments according to actual rather than predicted growth rates to keep the long-term growth of expenditures in check.

As the Foundation has articulated in previous research,¹ an expenditure limit containing some or all of these characteristics is better equipped to prevent the unnecessary growth of government than one that does not share in these traits.

So just how does Texas' constitutional tax and expenditure limit compare with the traits listed above? Unfortunately, not very well.

Inside Texas' TEL

Compared to other states' tax and expenditure limits, Texas' TEL is relatively weak. But that is not to say that Texans originally intended it to be that way.

In 1978, 84 percent of Texas voters overwhelmingly approved the *Texas Tax Relief Act*, a constitutional amendment they thought would restrain the growth of public sector spending. However, several built-in loopholes have prevented the TEL from being effective.

One such loophole has to do with the type of appropriations covered under the TEL. In Article VIII, Section 22(a) of the state's constitution, the only appropriations subject to the spending limit are those derived from "state tax revenues not dedicated by this constitution," which currently make up about half the budget. The other half consists of funds appropriated from other revenue sources—i.e., federal funds and non-tax proceeds, such as fees and fines—which are not subject to the TEL.

Another flaw that has weakened the ability of Texas' TEL to restrain the growth of government has to do with the measure used to establish the spending limit—personal income. Personal income is often a poor measure to limit the growth in state spending because as the state's residents become wealthier, they should require less government assistance, not more. A more accurate measure of the state's need for public goods and services is the sum of population growth plus inflation.

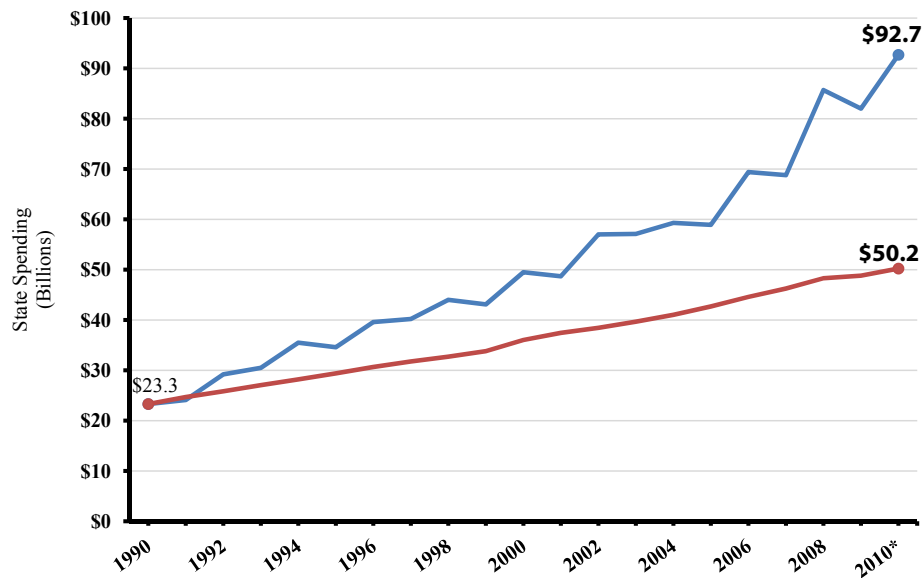
A low override standard also represents another stumbling block for Texas' TEL. With just a simple majority vote of each chamber, the Legislature can declare an "emergency" and bypass the appropriations limit altogether.

With the limitations of the Texas TEL addressed in the paragraphs above, the Foundation would like to lay out several recommendations on how to improve this important taxpayer protection.

Five Recommendations to Improve Texas' TEL

1. **Ensure it is self-contained within the state's constitution and does not require enabling legislation.** Texas' TEL should be self-contained within the state's constitution. In other words, there should be no need for enabling legislation. While this would theoretically add length to an already lengthy Texas constitution, 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.
2. **Applicable to all state spending.** In order to be effective, Texas' TEL should be applicable to all forms of state spending, including those involving federal funds. One advantageous aspect of including federal funds under the TEL umbrella is that 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.

State Appropriations vs. Appropriations Adjusted for Population Growth Plus Inflation



Source: Legislative Budget Board

- Based on the sum of population growth plus inflation or the growth in personal income, whichever is less. Currently, the only major restriction on the growth of state appropriations is the constitutional requirement that government spending not grow beyond the predicted growth in the state's economy. This has not been an effective limit.
- Expand the scope to include all levels of government within Texas. Texas' TEL cannot be effective if all levels of government are not included in its provisions.

Texas' TEL: An Issue for the 82nd Session

The state's current budget shortfall will require a significant reduction in the growth of government spending. A strong tax and expenditure limit will limit the volatility in government spending and thus help prevent future budget shortfalls. It is also a step toward enforcing greater government efficiency and accountability at every level.

Many states are facing extremely difficult cuts because their governments have grown unchecked for so long. If Texas does not make changes now to strengthen the TEL, the Texas Legislature can expect to face more tough cuts in the future. ★

Under the state's current constitutional restrictions, state spending has grown from \$23.3 billion in fiscal year (FY) 1990 to \$92.7 billion in FY 2010, a growth of approximately 300 percent. Had the state instead limited the growth to the sum of population growth plus inflation, state spending would have grown from \$23.3 billion to \$50.2 billion.

- Require a supermajority vote of each chamber to exceed the limit rather than just a simple majority vote. This ensures that the limit is not dependent on enabling legislation or fluctuating political will. Currently, the Texas Legislature can declare an "emergency" to bypass the appropriations limit with just a simple majority vote of each chamber.

¹ Byron Schlomach, Ph.D., "Texas' Appropriations Limit: Considerations for Future Reform," Texas Public Policy Foundation, July 2006.

About the Authors

The Honorable Talmadge Heflin is the Director of the Texas Public Policy Foundation's Center for Fiscal Policy. For 11 terms, Heflin served the people of Harris County as a state representative. 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.

Katy Hawkins is a research assistant for the Foundation's Center for Fiscal Policy.

About the Texas Public Policy Foundation

The Texas Public Policy Foundation is a 501(c)3 non-profit, non-partisan research institute.

The Foundation's mission is to promote and defend liberty, personal responsibility, and free enterprise in Texas by educating and affecting policymakers and the Texas public policy debate with academically sound research and outreach.

Funded by hundreds of individuals, foundations, and corporations, the Foundation does not accept government funds or contributions to influence the outcomes of its research.

The public is demanding a different direction for their government, and the Texas Public Policy Foundation is providing the ideas that enable policymakers to chart that new course.

