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Protecting Texas Taxpayers: Sales Tax Relief (STaR) Fund

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

Key Points

- The strong growth of state revenues creates the opportunity to provide Texans with tax relief.
- The Sales Tax Relief (STaR) Fund is the vehicle for returning excess revenue to Texas taxpayers.
- By restraining government spending, Texas' economy will continue to be the envy of all states.

Texas' Growing Economy Means Rapid Growth in State Revenue

The Texas model of low taxes, less regulation, and a sound civil justice system has contributed to the state's strong economic growth and national leadership in job creation. This has helped keep the state's unemployment rate at or below the national average for 85 consecutive months.

As measured by the Texas Public Policy Foundation's soft tyranny index, Texas has the nation's best combination of low taxes, no income tax, low government spending and a small number of regulators. The top 10 states with the least soft tyranny, led by Texas and South Dakota, bested the bottom 10 states, led by New York and California, in real private GDP growth by 64 percent from 2002 to 2012.[1]

The strong growth of the Texas economy has also led to a rapid growth in tax revenue. If these revenues continue on their current pace, they will create a sizable budget surplus for the state in 2015. This presents a major challenge for Texans concerned about maintaining Texas' strong economy; the Texas Legislature hasn't displayed much restraint recently when provided the opportunity to spend taxpayer money.

Comptroller Susan Combs projected that legislators would have an $8.8 billion surplus at the end of the previous biennium.[2] Instead of returning the money to Texas taxpayers—through a reduction in the sales tax, for instance, legislators spent every penny of it and more, dipping into the state's savings as well.

The strong growth of state revenues means the same thing is likely to happen in 2015 unless steps are taken to return excess revenue to Texas taxpayers.

Looking Forward to 2015

As the economy continues to expand and more people are employed, the Texas Comptroller reports that sales tax collections have increased for 46 consecutive months through January 2014. Since sales tax collections have increased by 28 percent since the 2008-09 biennium and are about 55 percent of total state tax collections, this increase contributed to a 25 percent increase in the state's total revenue over this period (*see Figure 1 next page*).[3]

Another growing source of state revenue is severance tax collections from a rapidly expanding oil and gas sector. A portion of these severance tax collections are transferred into the state's Economic Stabilization Fund (ESF), subject to a cap set by the Texas Constitution. If the cap is reached, any excess funds from severance tax collections are returned to General Revenue (GR).

For the 2014-15 biennium, the Comptroller calculates an ESF cap of $14.4 billion, whereby the Legislative Budget Board (LBB) projected in April 2013 a maximum monthly ending balance of $11.8 billion, or 82 percent of the cap, by August 2015 without withdrawals from the fund (*see Figure 2 next page*).[4]

Though amendments were passed last session to distribute dollars from the ESF given voters' approval, the trend of the ending balance over

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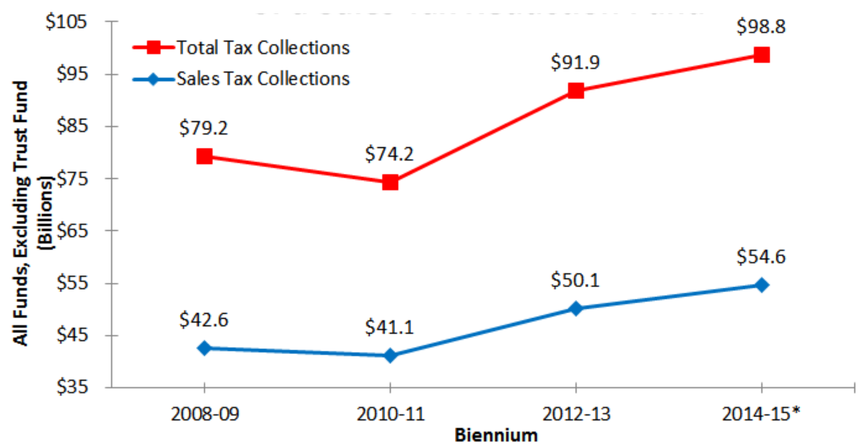
Figure 1: Rising Tax Collections Support Creation of the Sales Tax Relief Fund



*Source: Texas Comptroller, *indicates estimate*

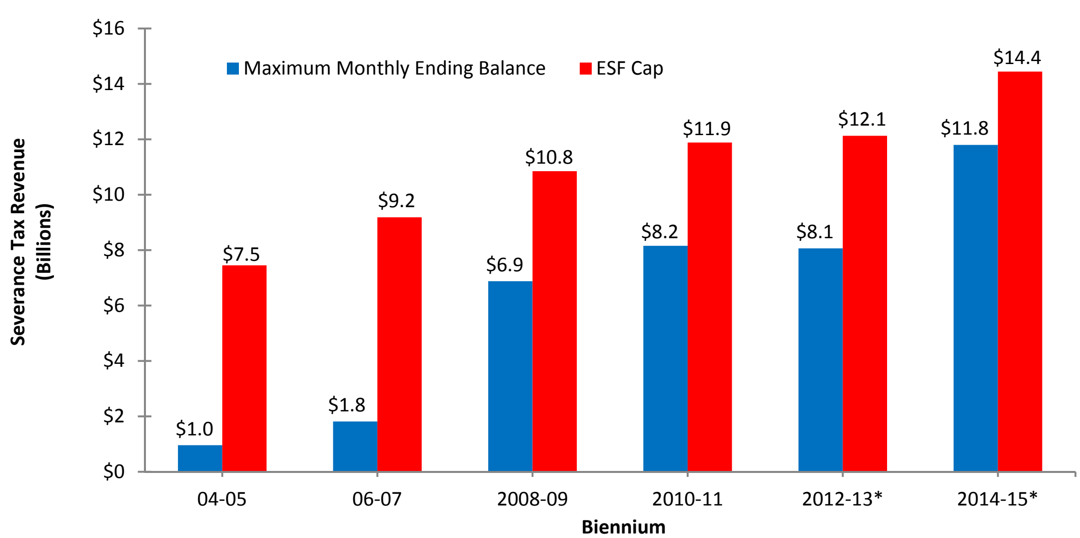
the last decade and the unprecedented increase in oil and gas production from the Eagle Ford Shale and the vast reserves in the Cline Shale strongly indicate the balance will reach closer to the cap soon.

According to two Tax Foundation reports, Texas is 45th in the nation[5] with the lowest state and local tax burden as a percentage of state income, but Texas' sales tax rate ranks 12th highest in the nation.[6]

Unless legislators find a way to reduce taxes, the Legislature will have more dollars to spend in 2015 from rapidly increasing tax collections. Given recent history, the increased tax revenue will likely be spent. A better solution would be for the Legislature to find a way to return excess funds to the taxpayer in 2015, improving the state's competitiveness in the process.

One reason for the continued expenditure of every available dollar is that there is no manageable way to reduce the

Figure 2: ESF Balance Reaches Closer to the Cap



*Source: Texas Comptroller, *indicates estimate* level of spending once the bill is voted out of committee. The level of spending is initially set by the leadership of both the House and the Senate in the appropriation bills filed in each body. At this point, members in both bodies face an almost insurmountable task of reducing the level of spending; in truth, spending levels almost always increase above the initial amounts in the bills.

The problem lies in the appropriations process. While members can offer amendments that reduce the amount of spending on specific programs, this doesn't lead to an overall reduction in spending. Instead, such amendments simply set aside the money and make it available for other members to appropriate for other purposes.

Attempts have been made to offer amendments cutting spending in one area and moving it to another. Most of these are defeated, since once the bills are filed the constituencies for spending on various programs mount effective challenges to such amendments. But even when they are successful, the level of spending remains the same. The beneficiaries are the constituents of the programs, never the taxpayers.

The only way to make it possible to reduce spending levels through the appropriations process is to include taxpayers as one of the constituents of the appropriations process.

Recommendation

To help sustain economic growth in Texas by reducing the growth in government spending, the Legislature should create a Sales Tax Relief (STaR) Fund that could temporarily reduce the state's sales tax rate in order to return excess revenue to Texas taxpayers. The STaR Fund will be funded in two ways:

- "appropriations" by the Texas Legislature directly to the STaR Fund, and
- funds in excess of the ESF's cap would flow directly into the STaR Fund rather than back into general revenue.

The statute creating the STaR Fund would authorize the Comptroller to lower the sales tax rate for a certain period based on the amount in the STaR Fund.

To calculate how much the Comptroller would reduce the sales tax rate to exhaust these funds over a chosen period, the Comptroller would use the previous year's sales tax revenue.

Consider the $25.8 billion of sales tax revenue in FY 2013.[7] Since the sales tax rate is 6.25 percent, each cent of sales tax raised $4.1 billion, according to a static analysis.

If the Legislature appropriated $517 million into the STaR Fund, the Comptroller would lower the sales tax rate by one-eighth of a cent for 12 months while transferring funds in the STaR Fund into general revenue. After the 12-month period, the sales tax rate would automatically revert to its original level.

Conclusion

By creating the STaR Fund, a vote against appropriating money into the fund would be a vote against tax relief, thereby creating an incentive for taxpayers to follow more closely the appropriations process. During a booming economy and energy sector, this simple approach to restraining the growth of government spending will help keep the Texas economy the envy of all states.

Endnotes

1. Texas Public Policy Foundation, *The Soft Tyranny Index*.
2. U.S. Bureau of Labor Statistics, *Regional and State Employment and Unemployment Summary*.
3. Texas Comptroller of Public Accounts, *The 2014-15 Certification Revenue Estimate*.
4. Legislative Budget Board, *Economic Stabilization Fund Cap*.
5. Tax Foundation, *Annual State-Local Tax Burden Ranking* (2010).
6. Tax Foundation, *State and Local Sales Tax Rates Midyear 2013*.
7. Texas Comptroller of Public Accounts, *The 2014-15 Certification Revenue Estimate*.

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 a policy analyst in the Center for Fiscal Policy at the Texas Public Policy Foundation in Austin, TX. Before joining the Foundation in September 2013, Vance interned at TPPF as a Charles G. Koch Summer Fellow in 2011 and anxiously awaited his return to fight for liberty. He is a Ph.D. economist and an accomplished author, teacher, and analyst.

In 2006, Vance 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 at Texas Tech University and graduated in 2013. He has successfully published several peer-reviewed articles in academic journals and commentary in newspapers and free market blogs. His research interests include free markets, fiscal policy, energy topics, monetary issues, and economic modeling.

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900 Congress Ave., Suite 400 | Austin, Texas 78701 | (512) 472-2700 | (512) 472-2728 fax | www.TexasPolicy.com