



The 2018-19 Conservative Texas Budget

by The Honorable
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Key Points

- Texas should make history in 2017 by passing its second consecutive conservative budget.
- The Conservative Texas Budget sets spending limits based on population growth plus inflation to slow the growth of state spending.
- Past spending trends show Texans are paying excessive taxes as the 2016-17 budget is up \$22.1 billion higher than increases in population growth plus inflation since FY 2004.
- The 2018-19 spending growth limit is an increase of no more than 4.5 percent, which provide limits of \$147.5 billion in state funds and \$218.5 billion in all funds.

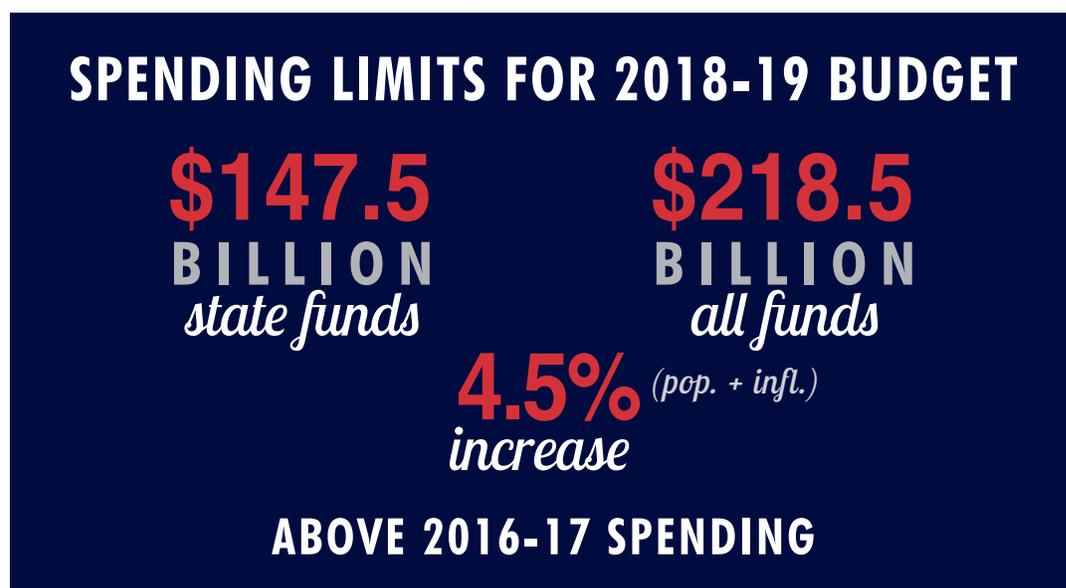
Introduction

The 84th Texas Legislature started in January 2015 with the state's coffers overflowing with cash from a robust economy. Instead of beginning the session by discussing how much to spend, legislators discussed how much to cut taxes. This action led to positive results in the budgeting process that provides a template for every legislative session: start with a discussion of how much to cut taxes, not how much to increase spending. The path to achieving this is by always passing a conservative budget.

Last session, the Legislature passed a generally conservative budget by keeping the increase in appropriations below the increase of population growth plus inflation. This key metric appropriately accounts for potential changes in government spending by considering changes in the population and the general cost of providing goods and services, such as healthcare and education. Specifically, the Legislature appropriated \$209.1 billion for the 2016-17 budget period ([LBB 2016](#)), 4.3 percent above what the Legislature appropriated in 2013 ([Heflin et al. 2016](#)). The [Conservative Texas Budget Coalition](#) deemed this a conservative budget because all spending was below population growth plus inflation of 6.5 percent during the previous two fiscal years (FY 2013 and FY 2014) ([Heflin and Ginn, 2015](#)), as derived from the Foundation's recommended spending limit reforms ([Ginn and Heflin 2015, 2](#)).

Chart 1:

The 2018-19 Conservative Texas Budget Sets a Spending Growth Limit of 4.5 Percent



Moreover, the budget also contained \$4 billion in tax and fee relief and left billions of dollars unspent, including more than \$10 billion in the state's rainy day fund. However, it must be noted that appropriations of state funds actually grew 7.1 percent, faster than population growth plus inflation. This will be a key metric to watch in 2017 in determining the conservative nature of the 2018-19 budget.

In addition, the amounts appropriated in the 2016-17 budget are \$209.1 billion in all funds and \$141.1 billion in state funds (LBB 2016). These were below the conservative caps of \$215.2 billion in all funds and \$142.3 billion in state funds; hence, it was a conservative budget. However, Texas Health and Human Service Commission's supplemental request of \$1.3 billion in general revenue for Medicaid, foster care, nursing facilities, and other areas, along with any other agency requests, to finish out the current biennium could exceed the parameters of population growth plus inflation. Given that this would negate the 2016-17 budget being conservative, we recommend that legislators work through these requests with the agencies and adopt a supplemental bill that meets the needs and stays within these parameters.

Keeping overall spending in line with the *Conservative Texas Budget* (CTB) helped keep the size and scope of government from further crowding out the productive private sector, especially when the economy cooled in 2015. Texas policymakers need to make passing a second consecutive conservative budget a priority in 2017. Doing so would boost the Texas economy by letting the private sector grow, following along the lines of the late economist Milton Friedman (1982, 84) who noted that "a rise in government expenditures relative to income is not expansionary in any relevant sense." In other words, government funds are simply redistributed taxpayer dollars with little economic benefit at best or are distortionary to the private sector with large economic costs at worst. Either result leads to the importance of restraining government spending growth by passing conservative budgets so that taxpayers are not burdened with excessive taxation.

Before the 2015 legislative session, legislators practiced some budget constraint in 2003 and 2011 when spending increases were less than corresponding increases in population growth plus inflation. However, subsequent legislatures in 2005 and 2013 increased spending substantially, erasing all of the gains from previous sessions. These past excessive spending trends have led to a state budget that has increased 11.8 percent above increases in compounded population growth plus inflation since the 2004-05 budget. This failure to practice consistent fiscal discipline has led to overspending (i.e., higher taxes) of \$22 billion during the current biennium, which amounts to average Texas families of four paying \$1,600 more in taxes this year (Heflin et al. 2016).

While the Legislature has occasionally passed conservative budgets, Texas needs to end the historical cycle of following conservative budgets with massive spending hikes. To prevent this and help rein in the growth of state spending, the Foundation has joined with the Coalition to propose the *2018-19 Conservative Texas Budget* (see Chart 1).

Under the *Conservative Texas Budget*, spending growth for state (non-federal) and all funds in Texas for the 2018-19 biennium would be limited to *no more than* population growth plus inflation during the previous two fiscal years (FY 2015 and FY 2016). This paper explains why the Legislature should use this metric and how the Foundation calculates these limits, which are based on the budget data chronicled in the Foundation's publication *The Real Texas Budget* (Heflin et al., 2016).



The Need for Spending Restraint

During much of the period since 2000, Texas has been America's job creation leader ([Ginn 2015](#)). The state's relatively low level of taxation, aided by the absence of a personal income tax, encourages economic growth and job creation, while supporting relatively modest government spending. This success is also found in other states without a personal income tax. Chart 2 summarizes the findings by Williams and Freeland ([2016, 24](#)). These statistics show states without a personal income tax have faster growth in their economy, job creation, population, and tax revenue than states with the highest personal income tax rates.

Chart 2: More Economic Prosperity in States Without a Personal Income Tax

For Years 2004-2014	Average of 9 States without a Personal Income Tax <i>(Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, Wyoming)</i>	Average of 9 States with the Highest Personal Income Tax <i>(California, Hawaii, Kentucky, Maryland, Minnesota, New Jersey, New York, Oregon, Vermont)</i>
State Population	+13.4%	+6.8%
Net Domestic Migration	+3.3%	-2.1%
Nonfarm Payroll Jobs	+9.7%	+4.7%
Personal Income	+55.3%	+44.3%
Gross State Product	+51.4%	+40.1%
State & Local Tax Revenue	+90.4%	+58.4%

Source: Williams and Freeland ([2016, 24](#))

These data provide valuable evidence that keeping tax rates low is important for economic success and more tax revenue, though the latter should not be the objective. The Texas economy has slowed from its previous rapid pace from headwinds such as a slower global economy, stronger U.S. dollar, and lower oil prices, making it imperative to minimally increase state spending so that taxes do not increase.

While Texas has done relatively well in controlling spending compared with most other states, Texas' current limitations on government spending are not sufficient ([Ginn and Heflin 2015](#)). One challenge with the constitutional spending limit is that it is on general revenue funds not dedicated by the constitution, or only about 45 percent of the total budget. This provides legislators with incentive to constitutionally dedicate funds to move them outside of the cap so that they can spend more under the limit and accept more federal funds, thereby increasing the entire budget without busting the cap. Another challenge with the limit is that the growth in the state's economy is determined in statute by projected personal income growth for the next almost three years when chosen as the growth limit. Not only is this problematic because it is difficult to project economic activity in a dynamic economy, but the use of personal income leads to budget instability that risks large swings from unexpected economic events ([Merrifield and Poulson 2014](#)).

Personal income is defined as "the sum of net earnings by place of residence, property income, and personal current transfer receipts" ([BLS 2016, 3](#)). This measure can be determined mathematically as population growth plus inflation plus productivity. If this equation is correct, the Foundation's preferred limit of population growth plus inflation fails to account for the importance of productivity. Regardless, an increase in private sector productivity does not necessarily require a corresponding increase in government spending. Moreover, a more productive private sector signals that the marginal return per dollar would be greater in the private sector, meaning that more dollars should stay there instead of being taxed to pay for higher government spending. If government productivity is considered in this calculation, it would be practically impossible to measure and would likely be zero over time.

Therefore, if this personal income equation is appropriate, productivity would either make the spending limit growth rate less than or equal to population growth plus inflation, which supports the use of it as an appropriate spending limit. If legislators deem that spending should grow by more than this limit, they have the flexibility to argue their case to voters and vote to bust the cap.

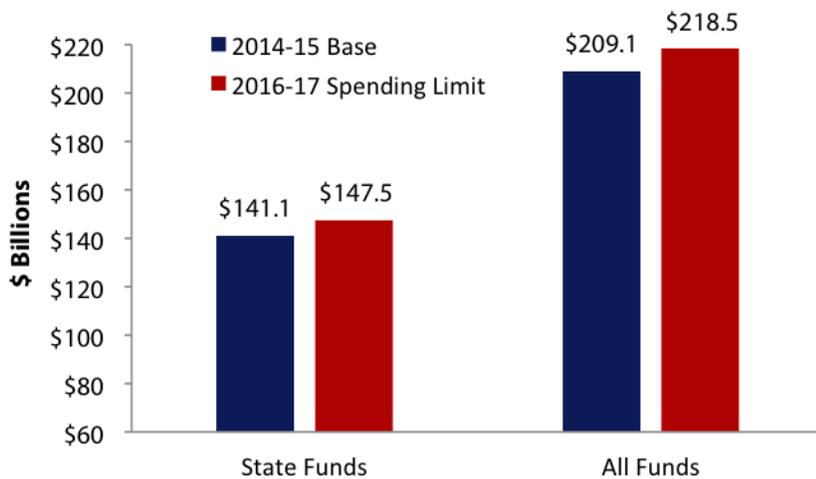
Given that state spending in Texas has increased 68.5 percent since 2004, or 11.8 percent faster than increases in compounded population growth plus inflation, it is clear that Texas needs spending limit reform. Passing a second consecutive conservative budget would go a long way toward proving to Texans that state government can function within a more appropriate limit than personal income growth.

The Conservative Texas Budget

Reining in state spending requires that the entire budget be subject to a spending limit based on population growth plus inflation for the last two fiscal years. The *Conservative Texas Budget* achieves this by setting spending limits that:

- Cap spending of both state (non-federal) funds and all funds. This avoids possible manipulation of the budget based on the volatility of federal funding and the constitutional dedication of funds to shift them outside of the current limit.
- Use as a base the 2016-17 appropriations in *The Real Texas Budget*: \$141.1 billion in state funds and \$209.1 billion in all funds.
- Are based on actual state population growth plus inflation data from the previous two fiscal years, eschewing the current reliance on an imprecise measure of state personal income forecasts over the next almost three years.
- Are based on the Foundation’s estimates of a 4.5 percent increase in population growth plus inflation over the two previous fiscal years (FY 2015 and FY 2016).
- Are \$147.5 billion in state funds for 2018-19, an increase of \$6.4 billion over 2016-17 appropriations, and \$218.5 billion in all funds, an increase of \$9.4 billion over current appropriations (see *Chart 3*).

Chart 3: The 2018-19 Conservative Texas Budget Spending Limits



Year	2016-17 Base	2018-19 Limit	Change	Increase
State Funds	\$141,101,500,000	\$147,451,067,500	\$6,349,567,500	4.5%
All Funds	\$209,103,000,000	\$218,512,635,000	\$9,409,635,000	4.5%

Source: Legislative Budget Board and authors’ calculations

Conservative budget reforms will provide Texas with the best opportunity to remain a free market bastion, thereby empowering Texans to reach their full potential and allowing the state to remain a model for others to follow.

These limits represent maximum amounts for the Legislature to use when determining the cumulative amount appropriated for each government agency. Note that the Legislature could easily spend less than this while ensuring payment of basic government goods and services and providing tax relief. Nonetheless, if the Legislature stays within these bounds in the *Conservative Texas Budget*, it will have taken a substantial step towards reining in the excessive growth of Texas government spending since 2004.

Calculation of Spending Growth Limit

Population growth and inflation from the beginning of FY 2015 to the end of FY 2016 (i.e., September 1, 2014 to August 31, 2016) were calculated based on the following:

- Population growth (3.2 percent): We used historical annual data for [Texas population](#) from the U.S. Census Bureau that represents population in the third quarters of 2014 and 2015. For FY 2016 we used projected data from the [Texas Comptroller](#). We calculated a population growth rate over the two fiscal years of 3.2 percent.
- Inflation (1.3 percent): We used historical quarterly data for the [consumer price index](#) (CPI) of all items for all urban consumers from the U.S. Bureau of Labor Statistics (BLS) for the entire period. We calculated an inflation rate over the two fiscal years of 1.3 percent.
- Population growth plus inflation (4.5 percent): Summing the population growth and inflation rates over this two-year period, we calculated a spending growth limit of 4.5 percent for the 2018-19 biennium.

Conclusion

The *Conservative Texas Budget* sets a spending growth limit of 4.5 percent for the 2018-19 budget. With 2016-17 appropriations as a base, the spending limits are \$147.5 billion in state funds and \$218.5 billion in all funds.

The 13 member organizations of the [Conservative Texas Budget Coalition](#) recommend that the Legislature pass the second consecutive conservative budget so that Texans have the best opportunity to prosper. While the *Conservative Texas Budget* would allow sizable spending increases from the current biennium, the Legislature could find ways to further limit the increase in government spending so that the excessive tax burden on hard-working Texans can be reduced.

Given the current economic climate of slower economic growth and job creation, less tax revenue will probably be available next session than in 2015. This may make it easier for the 85th Texas Legislature to pass another conservative budget. However, there will likely be proposals to appropriate more from the state's rainy day fund and spend every dollar available, thereby increasing the budget by more than this fiscally responsible limit. To avoid this, the Legislature's focus should be on how much in taxes to cut while holding the line in spending growth.

As a result, Texas will be better equipped to deal with economic downturns and other circumstances. Ultimately, conservative budget reforms will provide Texas with the best opportunity to remain a free market bastion, thereby empowering Texans to reach their full potential and allowing the state remain a model for others to follow. ★

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The Honorable Talmadge Heflin is the director of the Texas Public Policy 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.



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