



# Testimony

## Conservative Path to Limiting the Footprint of Government

*Presented to the Senate Finance Committee to Strengthen Texas' Limit on Appropriations*

by the Honorable Talmadge Heflin, Director

Chair Nelson and Members of the Committee:

My name is Talmadge Heflin and I am the director of the Center for Fiscal Policy at the Texas Public Policy Foundation, a non-profit, non-partisan free market think tank based here in Austin. Thank you for inviting me to speak today on the interim charge to consider spending limit options and what to do with dollars above the limit.

My remarks today are based on the Foundation's research findings that the current spending limit doesn't effectively limit Texas' budget growth and what reforms would strengthen it.

Texas has done better economically and fiscally than most states during the [last fifteen years](#). However, one area that still needs improvement is consistently controlling the state's budget growth. Since all government spending must ultimately be paid for by taxation, limiting budget increases is essential for a competitive economy that supports prosperity.

The 84<sup>th</sup> Texas Legislature appropriated \$209.1 billion for the 2016-17 budget period, which is a 2.9 percent increase from the previous period's expected expenditures. This conservative budget, defined as below population growth plus inflation, must be the first of many given past excessive budget trends. Population growth and inflation are two economic measures that account for most of the cost of funding public goods and services to a changing population. It is also noteworthy that these measures are added together because the addition of these two metrics accounts for economies of scale whereby the average cost of providing public services declines over time.

Legislators have recently practiced some budget constraint, particularly during the 2003, 2011, and 2015 legislative sessions when they passed budgets that increased by less than population growth plus inflation. However, in 2005 and again in 2013 spending by subsequent Legislatures increased substantially, erasing all of the gains from previous sessions. Specifically, the total budget is up an estimated 9 percent above the pace of compounded population growth plus inflation since the 2004-05 budget. This excessive increase has burdened Texans with higher taxes and fees to sustain elevated spending levels and slowed economic growth.

While occasionally passing conservative budgets is beneficial, Texas needs to keep past budget cycles from repeating by passing a stronger statutory spending limit. After conducting our own study and reviewing other research in search of which spending limits effectively restrain a government's budget, we find that Texas' spending limit can be traced back to several design flaws:

- **The current limit covers less than half of the budget.** In Article VIII, Section 22(a) of the Texas Constitution, the only appropriations subject to the spending limit are those derived from "state tax revenues not dedicated by this constitution," which is about 45 percent of the 2016-17 total budget. By not capping more than half of the budget, legislators are left with perverse incentives.
- **The current measure is not a reliable indicator for the budget's growth rate.** The Texas Constitution requires that the limit be based on the growth in the state's economy, which is statutorily identified as personal income growth. Research shows that this measure's instability leads to costly fiscal volatility and uncertainty.

- **The budget limit relies on a projected measure of economic growth.** Since several groups submit estimates of personal income growth to the Legislative Budget Board in November before a regular legislative session for the next two fiscal years, the projections are for about 33 months. The difficulty of accurately predicting this growth rate leads to large discrepancies between actual and projected growth rates.

With so many hindrances to budgetary prudence, it is easy to understand why Texas' spending limit has failed to effectively limit the state budget. With just a few changes, legislators can vastly restrain the growth of government by passing a conservative spending limit that allows Texans the best opportunity to prosper.

While using actual past population growth plus inflation data is sufficient in most cases, the day may come when inflation reaches levels like the 1970s that would not lead to a prudent spending limit. To avoid this concern, the Foundation suggests using the lowest rate of either population growth plus inflation, personal income, or gross state product for the two fiscal years immediately preceding a regular legislative session. This would allow Texans to have the ability to sufficiently fund essential government programs and no more.

Specifically, our recommended conservative spending limit includes:

- Passing a conservative spending limit that makes the following statute changes to Section 316 of the Government Code:
  - Applying the limit to Texas' total state budget.
  - Basing the limit on the *lowest* growth rate of the [Census Bureau's](#) measure of state population plus the [Bureau of Labor Statistics'](#) measure of inflation for the consumer price index for all items, the [Bureau of Economic Analysis'](#) measure of total state personal income, or the [Bureau of Economic Analysis'](#) measure of total gross state product for the two fiscal years immediately preceding a regular legislative session when the budget is adopted; and
- Putting a constitutional amendment on the ballot to change Article VIII, Section 22(a), such that a supermajority vote of two-thirds in each chamber instead of a simple majority is required to exceed the limit.

We would then suggest that any funds available above this limit, along with cuts in the budget or dollars above the rainy day fund limit, be used to keep the bottom line of the budget from growing. This can be done by passing legislation that would allow legislators to use those dollars in a fund to return them to the taxpayers by temporarily reducing the state's sales tax rate for a determined period and rate based on the amount in the fund. We've called this the Sales Tax Reduction (STaR) Fund.

Although the sales tax is in the name, a reduction in the sales tax rate is not the primary objective of the STaR Fund. The purpose is to reduce or restrain the bottom line of the budget. The secondary effect is reducing the sales tax rate because it has the broadest base and is the easiest to administer. Passing legislation to put the STaR Fund in place this session would allow it to be available in the 2019 Legislative Session, just in time for the implementation of the reformed conservative spending limit.

These reforms would help legislators limit the size and scope of the Texas budget, allowing Texans the opportunity to improve their well-being and achieve their dreams with their own resources.

Thank you for your time and I look forward to answering your questions. ★

